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EXAMINING THE REGULATORY FRAMEWORKS OF CORPORATE SELF-DEALING TRANSACTIONS UNDER THE SHARE COMPANY LAW OF ETHIOPIA: WITH PARTICULAR REFERENCE TO FINANCIAL SECTORS

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DECLARATION

I, the undersigned, declare that the thesis comprises my own original work and has not been submitted to any University for any awards and, in compliance with widely accepted practices, I have duly acknowledged and referenced all materials used in this work.

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The thesis titled "Examining the Regulatory Frameworks of Corporate Self-Dealing Transactions under the Share Company Law of Ethiopia: With Particular Reference to Financial Sectors" by Mr. Moyibon Kassa is approved for the degree of Master of Laws (LLM).

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Dedicated to my Mom

"Zenebu Eticha/Wawo/"

LIST OF ABBREVIATIONS AND ACRONYMS

Art.; Article

Arts. ; Articles

CS; Companies with Controlling Shareholders

Ed; editor

Edn; edition

E.g.; is short for 'exemple gracia' which, in Latin, means for example.

FSA; Financial Services Authority

GDP; Gross Domestic Product

Ibid; is short for ibidem which, in Latin, means in the same place

I.e.; is short for id est, in Latin, to mean, that is

NCS; Companies with Non-controlling Shareholders

NBE; National Bank of Ethiopia

No; number

OECD: The Organization for Economic Co-operation and Development

P; page

Pp; Pages

SA; South Africa

US; United States of America

UK; United Kingdom

Vol.; volume

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ABSTRACT

It is obvious that the problems of self-dealings or insider dealings that occurred often in the transactions of companies can create uncountable barriers on the overall development of the company itself and on other stakeholders' interests in general as it essentially divert the asset of the company to the opportunistic self-dealers. However, it is hardly possible to get sufficient scholarly writings and detail provisions to solve the matters in share company laws of different countries especially in our country Ethiopia. The available literature mainly deal with the corporate governance in general leaving aside the issues of corporate self-dealing transactions. This shows us that the subject matter of self-dealing transactions receives lesser attentions despite the potential dangers that it will create.

Besides, the Ethiopian share company law has no sufficient provisions to control corporate self-dealing transactions. There is only two articles which deals specifically with the concept of self-dealing without defining what it really mean self-dealing and what constitutes the acts of self-dealing transactions. Moreover, the articles regulate only directors, though not sufficiently, on how to engage in acts of self-dealing leaving other actors who can engage in acts of self-dealing and manipulate the asset of the companies. A close looking of international scholarly writings shows however that there are a lot of persons including the close relatives of the Directors, the managers of the company who are in the charge of day to day activities of the company and their relatives, the majority shareholders who owns the capacity to influence the decisions of the directors and managers, different officers of the company including accountants and legal advisers and other persons that has the opportunity to engage in the acts of the self-dealing transactions has to be regulated.

Furthermore, the share company law provisions do not answer the necessary mechanisms for stakeholders including minority shareholders to challenge the abusive self-dealing transactions that would be committed by opportunistic self-dealers and to get adequate remedies by subjecting them to relevant applicable law which shows us that the Ethiopian share company law has failed to solve the aforementioned problems. Generally therefore, this thesis tries to explore some issues with regard to these and other gabs in the law and literatures.

***Key words**: Corporate Governance, Self-dealing Transactions, Share Company Law, Ethiopia.*

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Earlier writings have increasingly focused on the corporate governance matters while generally discussing about the investor protection and it is only recently that scholars are paying attention to the issue of corporate self-dealing transactions separately under distinct heading.[1] In Ethiopia, however, the issues of corporate self-dealings are devoid of fair attentions from concerned bodies including Ethiopian legal scholars, practitioners, policy framers, law drafters, and stakeholders at large who are going to be affected ultimately by the acts of opportunistic self-dealers. Be this as it may, the concept of self-dealing is not similarly defined in the literature as there are differences in contents, forms, and actors engaging in it while explaining the concept.

For instance, in one scholarly writing self-dealing is defined as:

"[a] transaction, other than that concerning directors' compensation: (a) between the company and a director; or (b) between the company and another person, whenever a director has a 'personal interest in the welfare of the other person involved in the transaction, or in certain collateral consequences of the transaction' (hereinafter 'third-party transactions'); or (c) between another entity whose welfare affects that of the company (e.g. because the latter has a controlling interest in the former) and a director or another person, as identified in (b) above."[2]

As we can see from the definition it takes into consideration only the transaction/contract aspect, and directors' compensation and other forms of self-dealings are not clearly envisaged. But, in another article by *Djankov et al* it is recognized that:

"[t]here are various forms of self-dealing including executive perquisites, excessive compensation, transfer pricing, appropriation of corporate opportunities, self-serving financial transactions such as directed equity issuance or personal loans to insiders, and outright theft of corporate assets."[3]

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[1] Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer (2008), The Law and Economics of Self-dealing, *Journal of Financial Economics*, vol.88, No.3, pp. 430-465.
[2] Luca Enriques (2000), The Law on Company Directors' Self-Dealing: A Comparative Analysis, *International and Comparative Corporate Law Journal*, vol.2, No.3, p.299.
[3] Djankov et al, Supra note 1, p.430.

As such, when we look to these forms of self-dealing it implies that self-dealing refers to all kinds of transactions and operations whose aim is to divert value from a company to corporate controllers.

Again, the first definition takes only the transaction in which the interest of directors are in conflict with the company leaving other agency problem in which corporate self-dealing can be committed. As we know generally in agency law, the agency problem arises due to the different interest and the conflict between the principal and agent as principal delegate some decision making authority to the agent. In company law also, the principal agent problem is reflected in the management and direction related problems due to the differential interests of company's stakeholders in which among other things: a) the interests of shareholders are conflicting with the interests of managers and/or directors, b) the interest of majority shareholders are in conflict with the interest of minority shareholders, and c) the interest of company is in conflict with the interest of other stakeholders including employees of the company, creditors and society at large.

Among the above agency related problems, those persons who are in a position to control the overall management of the company (i.e., Directors, Managers and Majority shareholders) can engage in self-dealing transactions to benefit themselves at the expense of the company in general and in adverse to the rights of the minority shareholders in particular. Thus, it is generally accepted that, self-dealings are committed by specifically, those who control a corporation, whether they are managers (or directors), controlling shareholders, or both (as they may overlap sometimes), who can use their power to expropriate the company's asset for their personal interests.[4]

Once we have identified in what forms corporate self-dealing will be committed to know what constitutes self-dealing and after we understand who self-dealers are and who are not, it is necessary to identify legitimate/normal self-dealing from the abusive one. Because, all self-dealings cannot be considered useless and unfair as there are also self-dealing transactions which are legitimate and advantageous to both the company and shareholders if undertaken as per the law. So, in the words of Robert C. Clark:

"[t]hough they cause harm to the company when they are unfair, self-dealing transactions do not necessarily result in damage to the company. Self-dealing transactions are in fact defined as unfair

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[4] Ibid.

when 'the[ir] outcome ... is less advantageous [to the company] than the outcome would have been if the transaction had been agreed to, on [the company's] behalf, by a rational, well-informed decision maker who was independent and loyal, that is, not affected by a conflict of interest."[5]

That means, the mere fact that there are conflicts of interest in the transactions which are categorized as corporate self-dealing transactions cannot nullify the transaction by itself as long as it is under taken through proper procedures put in place by the law and the interest of the company and shareholders are not affected. The important question however is how is it possible to keep the balance between the two interests of the self-dealers on one hand and the interests of the company and shareholders on the other, while identifying legitimate/fair self-dealing from the abusive/unfair one.

The answer for this directly brings us to the approaches that are available to control the problems of corporate self-dealing transactions and related to this what would be the role of law to address the same. In this regard, literature dealing with the issue provides for different approaches including doing nothing as the market itself will control the problem, prohibiting all kinds of corporate self-dealing transactions, allowing corporate self-dealing by requiring it to undergo certain procedures, and lastly to allow it simply without any requirements but mandating the court to justify its fairness or otherwise if contentions follow.[6]

Of these approaches, to identify which one Ethiopia adopted as the methods to control corporate self-dealing transactions, for the purpose of this study it is necessary to look at the 1960 Commercial Code of the country which is relevant and applicable to the issue raised. Accordingly, the code devotes only few provisions which directly deal with the issue of corporate self-dealings and regulate only the self-dealings by directors leaving others particularly managers and controlling shareholders. Nevertheless, the detail of approaches and the mechanisms through which the victims (minority shareholders and the company) will get necessary redress from wrong doers in case abusive self-dealings are committed will be offered in the coming sections with the recommendations with which approach may help Ethiopia to have effective regulation of self-dealing transactions if recognized under its company law.

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[5] Robert C. Clark, Corporate Law (1986), p. 148–149, as cited in Luca Enriques, Supra note 2, p.299.
[6] Luca Enriques, Supra note 2, pp. 300-302.

Corporate self-dealings are not well regulated under the Ethiopian company law and there is no or few scholarly writings on the same. Yet, there is no doubt that the absence of necessary mechanisms to combat such corporate mal-practices has tremendous negative consequences on the development of company and economy of the country at large. Because, regulating the abusive corporate self-dealing obviously safeguards the rights of stakeholders particularly including the rights of minority shareholders, the economic interest of the companies and the country at large. Hence, the risk that corporate controllers (director or dominant shareholder) might maximize their own benefits to the detriment of the other stakeholders and the inability of the minority shareholders to monitor the agent are the main factors justifying the issue of mandatory regulation of corporate Self-dealing.

However, let alone providing the necessary mechanisms, self-dealings are nowhere defined under Ethiopian laws. However, defining the subject will tell what constitutes the acts of self-dealing transactions (forms) which in turn help to distinguish legitimate self-dealing from the abusive one, and also help to identify who are self-dealers and who are not. Moreover, providing the definition of self-dealings will help to understand its relations with other related concepts including insider trading and related party transactions. Thus, as explained above somewhere though there is no uniform understanding of the concept, self-dealing or sometimes called tunneling takes a variety of forms, including expropriation of corporate opportunities from a firm by its controlling shareholder, transfer pricing favoring the controlling shareholder, transfer of assets from a firm to its controlling shareholder at non-market prices, loan guarantees using the firm's assets as collateral, and so on. It can also take the form of financial as opposed to real transactions in which case dilution of minorities being the leading example.

On the other hand, the fact that the Ethiopian share company law did not address the problems of corporate self-dealing transactions can be evident from the works of Minga Negash writing in 2008 who indicated that the status of corporate governance in Ethiopia is disappointing and notes that "[t]he Commercial Code of 1960 does not provide adequate legislative response to complex governance issues of the day, and as the new draft corporate law has not yet been finalized investor and creditor protection laws are inadequate."[7] Besides, Fekadu Petros Gebremeskel by relying on

[7] See Minga Negash (2008), Rethinking Corporate Governance in Ethiopia, (University of the Witwatersrand), p. 2, available at http://ssrn.com/abstract=1264697, retrieved on December 15, 2016.

the data and literature on corporate governance, shows the deficiency of the Commercial Code in protecting the rights of minority shareholders in the context of publicly held companies.[8] Furthermore, Gebeyaw Simachew Bekele on the title termed 'A Critical Analysis of the Ethiopian Commercial Code in Light of OECD Principles of Corporate Governance' demonstrated that the Ethiopian share company law legal and regulatory framework apparently failed to achieve good corporate governance that can help not only improves economic efficiency and development but also builds investor confidence by analyzing it in light of the six minimum standards of OECD Principles of corporate governance.[9] Nevertheless, the above articles generally discuss about corporate governance and failed to fully address issues with the problems of corporate self-dealing transactions as they raised about it incidentally on their way to discuss about general issues of investor protections.

Therefore, by taking the above works some steps forward in order to deal with specific issues, this paper examines the law pertinent to the regulation of self-dealing transactions in governance of share companies in Ethiopia with a view to identifying dearth in the company law and suggests the solutions from internationally recognized best principles and practices of corporate governance, if any.

1.2. Statement of the Problems

The first problem under this title of study is the failure under our literatures and laws to answer the question what do the self-dealing and self-dealing transactions mean to clearly understand its concepts. Because, without having its clear meaning and apprehending the true concepts underpinning the subject matter it is difficult for everyone and in every subject to control the problems that would arise. In relation to this, defining the concept of corporate self-dealing helps to easily differentiate it from other related and sometimes confusing concepts like tunneling, insider trading/insider dealing and related party transactions. However, this concepts are not clearly and sufficiently identified and regulated by the share company law of the country though there are few provisions which deals with Self-dealing by the company Directors.

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[8] See Fekadu Petros Gebremeskel (2010), "Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications", *Mizan Law Review*, Vol.4, No.1, pp.1-30.

[9] See Gebeyaw Simachew Bekele (2012), A Critical Analysis of the Ethiopian Commercial Code in Light of OECD Principles of Corporate Governance, (Institute of Advanced Legal Studies, University of London), pp. 3-5, available at http://sas-space.sas.ac.uk/4733/1/Gebeyaw_Bekele_LLM_ICGFREL_dissertation.pdf, retrieved on December 20, 2016.

Thus, having the clarity in the above concepts will help to efficiently regulate the problem. On the other hand, there is no doubt that the absence of regulation of corporate self-dealing transaction has unbearable negative consequences on the development of the company and shareholders particularly and on the economic and other social aspects of the country at large. As such, it is important to regulate corporate self-dealing transactions in order to prevent the diversion of the asset of the company by the opportunistic self-dealers. This in turn help to protect particularly the economic interests of the minority shareholders and creditors of the company who are vulnerable in the acts of abusive corporate self-dealing transactions.

Second, questions what constitutes the acts of self-dealing transactions and who are prohibited from engaging in this activity has to be answered. It is only if these questions are answered that we can allow normal or legitimate self-dealing transactions and prohibit abusive self-dealing transactions that in turn help us to control the acts of abusive self-dealing transactions which is one of the aims of this research among other things. In our case however, the Commercial Code article 357 prohibits only the loans between directors and the company while allowing the directors to engage in the acts of self-dealing transactions under its preceding article 356 without saying anything on the self-dealing transactions by other parties that have the opportunity to engage in it.

Third, there is no clear position of the law on what available approaches have to be adopted to regulate and control corporate self-dealing transactions. Meaning, of the four principal solutions to the issue including Total Prohibition, Non-intervention, Approval Requirements by Dis-interested Party, and Fairness theory, which theory fits the regulatory framework of the country is not well articulated and do not answered by the writers on corporate governance law of Ethiopia. However, it is necessary to come up with the best solution from the above approaches that are provided under international literatures and the corporate laws of different developed countries to solve problems arises in relation to corporate self-dealing transactions. However, as the laws under the Commercial Code are outdated and on the way to be revised, the questions to determine which approach best serve the problems of Ethiopian corporate self-dealing transactions is not sufficiently answered and it is my hope that this research has something to contribute to this real life problem with this regard too.

Fourth, the question what relevant mechanisms we have to use to sanction and redress in case the abusive self-dealing transactions are committed has to be provided and fully answered along with

the above issues. However, since the way the minority shareholders and other stakeholders like creditors and employees are protected and the mechanisms to claim their rights are not sufficient under the share company laws of Ethiopia, it is necessary to devise adequate mechanisms in which a person wrongfully participated in self-dealing transactions become answerable under strong duties and responsibilities.

Last but not the least, determining the legal strategies which best protect shareholders from expropriation is necessary. Basically, the legal strategies available to protect shareholders from expropriation is divided into two major categories, i.e. Regulatory Strategies which are enforced through litigation and, Governance Strategies that are relying on shareholders' influence on management.[10] In short, they are the policy in which corporate law can directly constrain the controller's behavior or empower non-controlling shareholders to that effect, respectively.

On the one hand, in case of regulatory strategies the law controls the discretionary power of the corporate controller through shareholders litigation and independent review mechanisms. This is the regulatory strategies of the law which allow the imposition of self-dealings by controllers on minority shareholders, but allows the latter to litigate it in the court of law after (ex-post) the transaction, as similarly propagated by fairness approach which we are going to see it in Chapter two of this thesis. On the other hand, governance strategy allows the minority shareholders to challenge unfair decisions of the corporate controllers before it materializes (ex-ante) by setting certain procedural requirements including mandatory disclosure and approval of self-dealings by shareholders, and substantive standards including loyalty and arms' length requirements to which the controller must be guided.

In this respect researches shows that, although there is a major distinction between regulatory strategies enforced through litigation and governance strategies relying on shareholders' influence on management, these strategies can be equally effective at least in the US and the UK jurisdictions where shareholders are protected well.[11] However, there is no agreement among the scholars on

[10] L. Enriques, H. Hansmann and R.H. Kraakman, "The Basic Governance Structure: The Interests of Shareholders as a Class" in RH Kraakman, J Armour, PL Davies, L Enriques, H Hansmann, G Hertig, KJ Hopt, H Kanda and EB Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2nd edn, 2009), p.38.

[11] J Armour, BS Black, BR Cheffins and R Nolan, "Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US" (2009), *Journal of Empirical Legal Studies, Vol. 6,* p.687, as cited in Alessio M. Pacces (2011), Controlling the Corporate Controller's Misbehavior, *Journal of Corporate Law Studies, vol. 11, part 1,* p.178.

which strategy is efficient in protecting the shareholders from expropriation as some of them argue in favor of shareholder empowerment, while others argue against it, and some also advocate strengthening litigation, while others advocate restricting it.[12] In this study too, which strategy is efficient to strike a balance between the risk of misbehavior by those in control and the risk of opportunism by non-controlling shareholders in the regulation of corporate self-dealing transactions under Ethiopian share company law has to be analyzed.

1.3. Research Questions

The study will answer the following questions:

a. What is corporate self-dealing and its relations with other related concepts like insider trading and related party transactions?
b. Does the Ethiopian share company law govern self-dealing? If so, what approaches are used?
c. Are the relevant Ethiopian share company law provisions adequate to address the problems of corporate self-dealing transactions especially in its regulation of financial sector?

1.4. Objectives

1.4.1. General Objective

The general objective of the study is to investigate whether or not the Ethiopian share company law provisions adequately address the problems of corporate self-dealing transactions.

1.4.2. Specific Objectives

In addition to the above general objective, the specific objectives of the study include:

- To examine and describe the concepts and types of self-dealing by also making a contradistinction with other related concepts like tunneling, insider trading and related party transactions.
- Examining how the Self-dealing transactions are treated under the Ethiopian share company law.
- Identifying the gaps and strengths of the Ethiopian regulatory frameworks on corporate self-dealing transactions.

[12] See Alessio M. Pacces, Supra note 11, p.178.

1.5. Significance of the Study

The study has its own significance in pioneering the Ethiopian legal regime for regulation of corporate self-dealing transactions to protect both the interests of the minority shareholder particularly and of the company generally. As such firstly, by assessing the adequacy or otherwise of the Ethiopian share company law provisions on corporate self-dealing, the study will make different important recommendations to include or exclude some aspects of the law to rectify the gaps in the law. Next, by making clear, some concepts related to the problems of corporate self-dealing transactions, the study contribute to prohibit self-dealers not to engage in abusive self-dealing. Again, the study is important to show some important rights of minority shareholders to prevent the commission of abusive self-dealing transactions in advance and to seek remedies in case it has committed, which in turn protect the asset of the company not to be expropriated illegally. Furthermore, the study also will be used as an important input for those who have interest to conduct further study in the field.

1.6. Research Methodology

In conducting this study, both primary and secondary sources such as books, journals, and laws including relevant Codes and Directives are used as an important input for the work. Accordingly, to analyze the regulation of corporate self-dealing transactions under the share company law of Ethiopia in general and in the financial sectors in particular, the study will be conducted by using the following Primary and Secondary data:

- Relevant domestic legislations including relevant provisions of the 1960 Commercial Code of the country, proclamations and directives regarding the regulation of financial sectors, and relevant court cases, if any, will be exhaustively assessed.
- Relevant OECD Corporate governance Principles and standards regarding corporate Self-dealing transactions will be used as it is an important guidelines and best practices in corporate governance
- Books, journal articles, archives and internet sources including those used under the literature review part of the study will help to establish the concepts and theoretical frameworks on the subject of the study
- Different developed economies share company law and experiences particularly including those of US, UK, Germany, and France will be consulted. These countries are selected because firstly, those countries are selected in order to see the experience of the countries

both from the common law countries (i.e. US and UK) and from the Civil Law Countries (i.e. Germany and France) that helps to appreciate trends, differences and similarities of their legal frameworks. And secondly, the long history on good corporate governance and the different companies scandals that happens especially in US and UK necessitates for efficient control of corporate self-dealing in their company law. For instance, in a variety of respects, the US and the UK stand out as good choices for this study from common law jurisdictions as both offer a friendly environment for contractual performance (including self-dealing transactions).[13] Above all, the experience of these developed countries are relevant as the economic gap between the developed and least developed or developing has no effect on the regulation of self-dealing transactions. As it is empirically researched by Djankov et al, the differences in the regulation of self-dealing cannot be explained by differences in income levels as the correlation between anti-self-dealing and (log) GDP per capita is a statistically insignificant (i.e. 0.16).[14] Thus, both rich and poor countries may optimally choose to regulate self-dealing transactions and it is possible for the least developed or developing countries (particularly Ethiopia) to select and follow the best experience among the above mentioned developed countries. Nevertheless, in order to ensure fair representation of the sample countries experience, the thesis will try to address the experience of two emerging countries from Africa to see their success in the regulation of self-dealing transactions. Thus, the experience of Kenya and South Africa is relevant as both jurisdictions recently undertake different reforms in their corporate law by promulgating Companies Act in 2015 and 2008, respectively.

- Besides, to analyze how the Ethiopian company law address the problems of corporate self-dealings, I have selected the three important major factors that used by many scholars to assess the effectiveness of a discipline of self-dealing transactions.[15] Accordingly, those

[13] See Raphael La-Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny (1998)," Law and Finance", *Journal of Political Economy, Vol.106, No.6.* In their pioneering study on the impact corporate law has on the strength of securities markets for instance, they illustrate that not only that the US and the UK score better than most other countries but also score much the same as each other: the efficiency of the judicial system (10 out of 10 for both countries), the rule of law (10 for the US and 8.57 for the UK), corruption (9.10 for the UK and 8.63 for the US), the risk of expropriation of asset by the government (9.98 for the US and 9.71 for the U.K) and the risk of contract repudiation by the government (9.98 for the UK and 9.00 for the US).

[14] See Djankov et al, Supra note 1, p.20.

[15] See, Gilson, R.j. (2006) "Controlling Shareholders and Corporate Governance: Complicating the Taxonomy" *Harvard Law Review,* vol. 119, p.1653, as cited in Alessio M. Pacces, Supra note 11.

major factors used to assess the effectiveness of a discipline of self-dealing include:[16] 1) *Disclosure*, which enables to discover abusive self-dealing that result in unlawful expropriation of the asset of the company; 2) *Standard,* to determine whether certain self-dealing/related party transaction is abusive or legitimate; and 3) *Enforcement*, whereby both disclosure and standard are applied to prevent or deter expropriation. Thus, these factors are used in this thesis as an important factors to measure the adequacy or otherwise of the share company law of Ethiopia in addressing the problems of corporate self-dealing transactions. Besides, not only its effectiveness but also the efficiency of the regulation is also tested against the false positives and false negatives analysis provided in the law and economics scholarships as discussed in chapter two of this thesis.

- Lastly, to assess whether the share company laws are adequate, the "Anti-Self-dealing Index" which is identified by Djankov et al., and recognized globally[17] as an important Index to measure the company-level or a country-level regulation of corporate self-dealings is employed in this study. Obviously, the present study is aimed at measuring the country-level (i.e. Ethiopia's) regulation of corporate self-dealings. Hence, the study will use the Anti-Self-dealing Index which will start by measuring the score for Ex-ante private control of self-dealing and then the score for Ex-post private control of self-dealing. Accordingly, the principal component or variables of Ex-ante private control of self-dealing include: (1) approval by disinterested shareholders; (2) disclosures by buyer; (3) disclosures by Mr. James; and (4) independent review. Each of these components given their respective points and the average of the last three components give us the score for ex-ante disclosure. Then the average of ex-ante disclosure and the first component equals the Ex-ante private control of self-dealing. Next, the score for Ex-post private control of self-dealing will be done and thus, its principal component or variables include: (1) each of the elements in the index of disclosure in periodic filings; (2) standing to sue; (3) rescission; (4) ease of holding Mr. James liable; (5) ease of holding the approving body liable; and (6) access to evidence. Again, each of these components given their respective points and the averages of the scores of the last five components give us the score for Ease of proving wrongdoing. Then

[16] See, Alessio M. Pacces, Supra note 11, p.192.

[17] Lucian A. Bebchuk and Assaf Hamdani (2009), The Elusive Quest for Global Governance Standards, *University of Pennsylvania Law Review*, vol.157, No.5, pp. 1263-1317.

the average of Ease of wrong doing and the first component equals the Ex-post private control of Self-dealing. Lastly, the average of Ex-ante private control of self-dealing and Ex-post private control of Self-dealing will be done to establish the score of Anti-Self-dealing Index. Hence, the overall Anti-Self-Dealing Index is the combination of both the ex-ante and ex post indices which are scaled from zero to one and collected from the relevant laws of 72 sample countries as done by Djankov et al. In the words of the researchers, "the index addresses the ways in which the law deals with corporate self-dealing."[18] Similarly, the score for the indices (elements) mentioned above that help to establish the Index of self-dealing for Ethiopia is also going to be identified from the letters of relevant laws of the country, not from other empirical data.

In sum, the study is purely doctrinal as it analyzes the adequacy or otherwise of the share company law of Ethiopia with regard to corporate self-dealing transactions in general.

1.7. Limitations

The main limitations of the study are two fold; shortage of times (since this research has to be accomplished within few months) and lack of necessary materials on the subject of the study. Of course, financial constraints are also another problem to conduct observations and questionnaires which will help to conduct empirical study on the field to sufficiently address all problems related with the subject matters in relevant sectors. Moreover, since many of my secondary sources was from the internet, the interruption of connection and unavailability of materials-especially books concerning this title was great challenges in conducting this study.

1.8. Scope of the Study

This study is principally limited to the analysis of laws under the 1960 Commercial Code of Ethiopia regarding corporate self-dealing transactions. Nevertheless, it will include the specific legislations on financial share companies and other financial institutions especially the Banking sector of the country. Besides, from the types of regulation (i.e. Private regulation through governance and regulatory strategies and Public regulation through criminal sanctions and fines) of corporate self-dealing transactions the study mainly focus on the ability of private shareholders to control the problems of self-dealing transactions.

[18]See Djankov et al, Supra note 1, p.5.

Generally, the study is limited both in the geographic area and the subject matter of discussion as it is confined to the regulation of self-dealing transactions in general with particular reference to the financial sector of Ethiopia.

1.9. Organization of the Research

The thesis is organized in the manner that would give clear, consistent and coherent understanding of the general message of the study by dividing the work in to four chapters. The work plan of this study entirely depends on the whole organizations of chapters of the study and accordingly, the proposed chapters are as follows. The first chapter is introduction, which is designed to give information to the reader what necessitated the commencement of study and includes the general background of the study, statement of the problems, research questions, objectives, scope, methodology, limitations and significance of the study.

Then, chapter two discusses the general overview of self-dealing transactions which has embraces definitions and explanations on the concept of self-dealing and its relations with other concepts including insider trading and related party transactions. Besides, this chapter also contains the available approaches to deal with the problems of self-dealing and the experience of some selected countries with regard to corporate self-dealing transactions.

The next part which is chapter three of the paper is the main theme of the study which analyses the Ethiopian share company laws to assess its adequacy in regulating the problems of corporate self-dealing transactions. The last chapter brings the study to the end by the conclusion and recommendations made by the writer.

CHAPTER TWO

AN OVERVIEW, APPROACHES AND EXPERIENCE OF SOME SELECTED COUNTRIES ON CORPORATE SELF-DEALING TRANSACTIONS

2.1. The Understanding of Corporate Self-Dealing Transactions in Corporate Governance

As the issue of corporate self-dealing is a sub-set of corporate governance it is preferable to begin by defining the latter concept. Because, as it was mentioned above in the Introduction part, earlier writings has focused on the corporate governance matters while generally discussing about the investor protection and it is only recently that scholars are paying attention to the issue of corporate self-dealing transactions separately under distinct heading.[19] To show this development and the relation between the two, it is necessary to have a brief glance about corporate governance as it is the base for discussion of the corporate self-dealing transactions. To begin from the importance of having good corporate governance, it is undeniable fact that the existence of appropriate and effective legal, regulatory and institutional underpinnings are backbones for a given country's sound corporate governance framework as it in turn fosters market integrity, improves economic efficiency and growth as well as builds investor confidence.[20] Thus, good corporate governance is fundamental to the economies and also facilitates the success for entrepreneurship in a given country.

Coming to its definition, as Berle and Means writing in 1932 and the even earlier, Smith in 1776 rightly puts, as there is no single definition of corporate governance than it might be viewed from different angles, different scholars defines it differently.[21] For instance, La Porta, Silanes and Shliefer (2000, 2002) view corporate governance as a set of mechanisms through which outside investors (i.e. minority shareholders) protect themselves from inside investors (i.e. managers and controlling shareholders).[22] To add more definition of corporate governance, Garvey and Swan writing in 1994 asserts that "governance determines how the firm's top decision makers (executives) actually administer such contracts", while Shleifer and Vishny writing in 1997 define corporate governance as "the ways in which suppliers of finance to corporations assure themselves

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[19] See Djankov et al, Supra note 1.
[20] See Gebeyaw Simachew Bekele, Supra note 9, p.39,
[21] Humera Khan (2011), A Literature Review of Corporate Governance, Management and Economics, (*IACSIT Press, Singapore*), Vol.25, p.2.
[22] Ibid.

of getting a return on their investment".[23] When seen generally, however, corporate governance nowadays refers to all the issues in relation to ownership and control of corporate property, shareholders' rights and treatment, powers and responsibilities of the board of directors, disclosure and transparency of corporate information, the protections of the interests of stakeholders in addition to that of shareholders, enforcement of rights, etc.[24] It means that as issues covered under corporate governance are large and cannot necessarily and directly address the problems of self-dealing, we can grasp from the definitions that self-dealing is one of the most important corporate governance issues that needs special attentions.

Particularly, to see corporate governance from point of the agency related problems which include how to control corporate self-dealings, a scholar named Core, in 1999 asserts that firms which has weaker governance to direct and manage company matters face greater agency problems.[25] Consequently, governing a corporation should be a problematic perhaps because a corporation has a special kind of investors (i.e. shareholders), who share in the ownership of the corporation but are not necessarily entitled to participate in the decisions on how the corporation is to be managed.[26] This is the point where the issue of separation of ownership and control that is a typical feature of listed companies (i.e. known as Share Companies in Ethiopia) gives rise to agency problems. Normally, agency arises when one party nominated as an 'agent' acts for or on behalf of or as a representative for the other, designated as a 'principal'.[27] Thus, an agency problem lies in encouraging the agent to act in the principal's interest rather than simply in the agent's own interest.

Generally as revealed in Henry Hannsmann *et al.*, agency problems in company will happen in three different ways due to the conflict of interests between the stakeholders involved in the

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[23] Ibid.

[24] Corporate Governance in Developing Countries: Shortcomings, Challenges and Impact on Credit http://www.uncitral.org/pdf/english/congress/Cooper_S_rev.pdf , p. 3, as cited in Fikadu Petros Gebremeskel, Supra note 8.

[25] Humera Khan, Supra note 21, p.1.

[26] Hellwig, M. (2000), On the Economics and Politics of Corporate Finance and Corporate Control, as cited in Alessio M. Pacces (2007), Featuring Control Power; Corporate Law and Economics Revisited, (Rotterdam, Institute of Law and Economics), p.40, available at file:///C:/Users/User/Downloads/Pacces%20DISSERTATION%20(2007-2008).pdf, Retrieved on April 13, 2017.

[27] Oliver D. Hart, "Incomplete Contracts and the Theory of the Firm" (1988) 4 J. L. Econ. & Org. 199, as cited in Shanthy Rachagan (2006), Agency Costs in Controlled Companies, *Singapore Journal of Legal Studies*, p.268, available at file:///C:/Users/User/Downloads/SSRN-id1070935%20(1).pdf, retrieved on April 13, 2017.

company.[28] As to them, the first comprises the conflict between the firm's owners and its managers where the owners are the principals and the managers are the agents. The problem in this type of agency problem lies in ensuring that the managers are receptive to the owner's interests rather than the managers' own personal interest. As such, this is the agency problem in the company where there are no controlling shareholders, which form Non-controlling shareholders' Companies (here in after, NCS Companies). In this type of company, as all shareholders are non-controlling (i.e. they do not own shares which enables them to dominate others) the decision making power is mandated to the managers of the company. Here, company law is responsible to regulate the relationship between the shareholders as principals and the managers who are the agents.

The second agency problem they say involves the conflict between the owners who possess the controlling interest in the company and the minority who are the non-controlling owners.[29] Here the difficulty lies in ensuring that the non-controlling owners who are the principals are not expropriated by the controlling owners (i.e. those who possess the majority of the shares and thereby influence the decision making power of the managements) who are the agents by, for example, self-dealing. Lastly, they identify the third agency problem as involving the conflict between the company as an agent and other parties with whom the company contracts as principals, such as employees, creditors and customers.[30] Here, the difficulty lies in assuring that the firm, as agent, does not behave opportunistically towards the principals, such as by exploiting workers and expropriating from creditors.[31]

Of these three types of agency problems, the present study mainly concerns with the first and the second one as the third one is vast and concerned with many disciplines which is beyond the scope of this work. On the other hand, the first and second type of the company's agency problems are relevant as they are related to the subject of this topic. Because, it is due to these agency related problems that those persons who are in a position to control the overall management of the company (i.e., Directors, Managers and Controlling shareholders) engage in self-dealing

[28] Henry Hannsmann & Reinier Kraakman, "Agency problems and Legal Strategies" in Reinier Kraakman et al. eds., The Anatomy of Corporate Law: A Comparative and Functional Approach (New York: Oxford University Press, 2004), p.21, as cited in Shanthy Rachagan, Supra note, 27.
[29] Ibid.
[30] Ibid.
[31] Ibid.

transactions to benefit themselves at the expense of the company in general and in adverse to the rights of the minority shareholders in particular.

Thus, the agency problem leaves a way for the company controllers (managers and/or directors and majority shareholders) to extract more private benefits which eventually badly harm the growth of the company. To address these problems of agency relationships, corporate governance has to ensure fundamental shareholders rights including right to dividend, protection of corporate assets from misuse by opportunistic self-dealers/insiders, minority rights to representation in the board, challenging the decision of the board in a court of law, suing the board or third parties on behalf of the company, and leaving the company upon free will, etc.[32] Though safeguarding all these rights is the mandate of the company law to ensure good corporate governance, particularly it also serve to challenge the abusive self-dealing not to be committed or to get redress for the victims in case it happened.

However, as company law of any country cannot perfectly answer all of the issues raised above and due to lack of necessary information and resources, shareholders are usually unable to closely monitor management, its strategies and its performance in companies with dispersed ownership (i.e. NCS Companies).[33] Besides, in companies with concentrated ownerships (i.e. CS Companies) the rights of minority shareholders can be easily infringed by the majority shareholders who can use their vote rights to influence decisions on important issues of the company going to the extent unfairly extracting the asset of the company unless regulated by the law. Thus, in order to protect the rights and interests of minority shareholders and prevent illegal expropriation of the asset of the company by the corporate controllers, the law has to design the mechanisms how to control corporate self-dealing. However, the share company law of Ethiopia including the proclamations and directives governing financial share companies does not sufficiently address the aforementioned issues.[34]

[32] See, OECD Principles of Corporate Governance, (2004).
[33] See Report of High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, (4 Nov. 2002), p.59.
[34] Hussein Ahmed Tura (2012), Overview of Corporate Governance in Ethiopia: The Role, Composition and Remuneration of Boards of Directors in Share Companies, *Mizan Law Review Vol. 6, No.1*, p.46

2.2. Explaining Self-Dealing, Tunneling, Insider Trading and Related Party Transactions

Before directly rushing to the rules and regulations governing self-dealing, it is useful to explain the concepts behind it and its relations with other related concepts for more clarifications. Accordingly, the coming paragraphs will hinge on the same purpose. To begin with, consistent definitions are considered vital in reducing or avoiding misunderstandings and excessive regulatory burden. Because, without proper definition, important measures and regulatory framework to tackle the problems of corporate self-dealing likely lacks an impact.

Again, this is because inconsistent definitions spread across various laws and regulations in a country may cause confusion for those enforcing them and may result in an unnecessary regulatory burden.[35] Thus, looking first at the definitions of what makes a person a self-dealer and a given transaction a "self-dealing transaction," is important to have a better understanding of the whole topics. Besides, as there is clear overlap between the term "self-dealing transaction," and other terms including: "related party transaction", "insider trading," and "tunneling"[36] it is necessary to look at the contradistinctions between these related concepts.

2.2.1. Nature and Types of Corporate Self-Dealing Transactions

Normally, it is the existence of the two major actors in corporate governance which raises the issue of the separation of ownership and control which in turn is the building block of issues of corporate self-dealings.[37] These are, on one hand the "management" who are responsible to manage (i.e. control) the company and, on the other hand the "shareholders" who are there to provide the finance for the existence of the company (i.e. ownership) but not necessarily entitled to manage it.[38] This implies that the management should be accountable to shareholders in order to avoid the risk of expropriation of the asset of the company by the former and thus, the law should support this accountability in order to minimize agency costs between these stakeholders particularly, in preventing corporate Self-dealings.

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[35] OECD: "Guide on Fighting Abusive Related Party Transactions in Asia," Corporate Governance Series, September 2009, p.17, available at www.oecd.org/daf/corporateaffairs/corporategovernanceprincip, Retrieved on March 12, 2017.

[36] Elaine Henry et al. (2012), "The Role of Related Party Transactions in Fraudulent Financial Reporting", *Journal of Forensic & Investigative Accounting Vol. 4, Issue 1*, p.191.

[37] See Alessio M. Pacces, Supra note 11, p. 180.

[38] Ibid.

Corporate self-dealings become the core element of the separation of ownership and control because, as explained in chapter one of this study, corporate self-dealing arises in transactions involving a conflict of interest between a member of the company and the company itself. Hence, Self-dealing is the complex problem that may be found in many corporate actions and deals including those between a company and the party controlling it, a subsidiary, a director or officer of the company, or any other entity in which a shareholder and/or other company controllers may have an interest.[39] Having saying this, it is now important to see the nature and types of the corporate self-dealings depending on who are engaging in it, how they are engaging in it and in what types of companies it occurred. Accordingly, the types of corporate self-dealings can be generally seen from three different views of corporate governance.

First, let us see the nature and types of corporate self-dealings from the point of view of the two main types of companies: Widely Dispersed Companies or Companies with Non-controlling Shareholders (shortly known as NCS) in which there are no controlling shareholders and Concentrated Companies or Companies with Controlling Shareholders (shortly known as CS) that have controlling shareholders. On the one hand, in the majority of listed companies with controlling shareholders (i.e. CS Companies), the management is accountable to dominant or the so-called "controlling" shareholders[40]. Here it is to say that, the controlling shareholders can influence the decision making power of the managements using the shares they own in the company and the management cannot protect the interest of the company and of the minority shareholders as a result of the influence by the former. It refers that, in concentrated ownership structures, the conflict of interests which give rise to agency problem has to be identified between the controlling shareholders and the outside investors and the operation of self-dealing in this type of company is commonly known as Controlling shareholders' self-dealing.[41]

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[39] See, See Zohar Goshen (2003), The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality, *California Law Review*, Vol.91, No.2, p.396.

[40] A controlling shareholder is one that controls sufficient votes to effectively determine voting outcomes and corporate decision-making. And, a controlling shareholder does not necessarily own or control the majority of voting rights. In fact, listed companies can be effectively controlled with 25% of voting rights, or even less, held by one dominant shareholder or a coalition of them. . See generally, Lucian A. Bebchuk & Assaf Hamdani, Supra note 17.

[41] M. Pizzo, N. Moscariello, R. Vinciguerra, The Regulation of Self-Dealing in Europe, among convergence and path-dependency opportunities: A comparison between disciplines of some Eastern and Western Countries, (University of Naples II, Italy), p.4, available at file:///C:/Users/User/Downloads/The_Regulation_of_Self-Dealing_in_Europe_among_con%20(1).pdf accessed on January 5, 2017.

On the other hand, in those companies with Non-controlling shareholders (i.e. NCS Companies), the management appears to be more powerful than the shareholders as there are no controlling shareholders who can influence the decision making power of the management. Thus, in a dispersed ownership system, as the conflict of interests to be raised in case of self-dealing is between the powerful controlling managers and minority shareholders we can call such type of self-dealing, the managerial self-dealing.[42]

As such, differences in share ownership might shape the nature of self-dealing and thus, depending on by whom and/or in which type of companies the corporate self-dealing transaction can be committed we can divide it to Managerial self-dealing and Controlling Shareholders' self-dealing. In short, the agency problem under concentrated ownership is fundamentally different from that under dispersed ownership. While the primary agency problem for dispersed shareholders is to control powerful management, an additional agency problem arises under concentrated ownership, namely, the control of dominant shareholders and their influence over management.

Indeed, the two type of self-dealing may overlap as it is possible for controlling shareholder to be the manager or director of their company.[43] Here, if the controlling shareholder is involved in the management of the company, the conflict of interest raised will be considered as between both the manager and/or controlling shareholders and the minority shareholders. However, the fact that they may overlap doesn't mean single legal tools can effectively tackle the opportunistic self-dealers in different types of companies and thus, identical rules might have different effects on the conflict of interests issue as influenced by the context which they are designed to regulate.[44]

Therefore, the corporate governance regulation in general and, the regulation of corporate self-dealing in particular should be designed differently to control self-dealing depending on whether it is Managerial or Controlling Shareholders' Self-dealing. However, as we are going to see it in Chapter three of this thesis, the Ethiopian Share company law does not envisaged such differences while regulating self-dealing transactions.

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[42] Ibid.

[43] Ibid.

[44] Ibid.

Second, based on the way how the corporate controllers extract the asset of the company, self-dealings come in two forms.[45] On the one hand, a controlling shareholder can simply transfer resources from the firm for his own benefit through self-dealing transactions including outright theft or fraud, asset sales, contracts such as transfer pricing advantageous to the controlling shareholder, excessive executive compensation, loan guarantees, expropriation of corporate opportunities, and so on.[46] Mainly, this instance of the appropriation by the corporate controller, is typically through a related entity that he may own exclusively, of investment opportunities that may be as profitably exploited by the corporation. In sum, this form of self-dealing involves those transactions in which controllers (e.g. directors, influential managers and controlling shareholders, including their close relatives or companies owned by them and/or their close relatives) directly deal with the corporation. Typically, this might involve purchases or sales of corporate assets by controllers and corporate guarantees in favor of controllers not being based on arm's length negotiations and tend to be unfavorable to the corporation. This forms of extracting the corporate asset can be called "Direct" corporate Self-dealings.

On the other hand, corporate controllers can increase their share of the company without transferring any assets but through dilutive share issues, minority freeze outs, insider trading, creeping acquisitions, or other financial transactions that discriminate against minorities.[47] In addition, this diversion is typically implemented through some form of corporate restructuring including mergers or divisions, spin-offs, winding-up, and the like.[48] As a result, the original ownership claim of non-controlling shareholder may be diluted through these restructurings, in favor of the corporate controller or of one related party of his, with nothing being formally diverted from the corporate assets, investment opportunities, or cash flow potential. This kind of expropriation of the asset of the company can be called "Indirect" corporate Self-dealings.

Thirdly, by looking at the way the conflict of interests are handled and its merits and demerits to the company and to all shareholders as a group, corporate self-dealing can be divided in to

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[45] Simon Johnson, Rafael La Porta Florencio, Lopez-de-Silanes and Andrei Shleifer (2000), "Tunneling", *American Economic Review Papers and Proceedings, Vol.90, No. (2),* pp.22-27, available at, https://scholar.harvard.edu/files/shleifer/files/tunneling.pdf, retrieved on March 20, 2017; See also, Chris Chadien (2016), The Law on Corporate Opportunity Transactions by Directors: A Comparative Analysis of Delaware Law and Australian Law, *Journal of Law and Social Sciences, Vol.5, No.1*, p. 28.

[46] Ibid.

[47] Ibid.

[48] Ibid.

Abusive/Unfair and Legitimate/Fair Self-dealings. On the one hand, depending on the above explanations one may conclude that corporate self-dealing transactions violates the principle of corporate governance which prescribes that distributions of the company's assets and residual cash flows must be made pro rata (i.e. according to their share of ownership in the company) to all shareholders.[49] Besides, this is because as Self-dealing transactions obviously involves conflict of interest in determining the exchange price, transactions of this kind are extremely dangerous for non-controlling shareholders. Here, the risk involved by such a kind of transaction is very clear as a corporate controller vested with discretionary powers will naturally tend to set the transaction terms in such a way as to foster his own interest at the expenses of that of the company (and thus, ultimately of non-controlling shareholders).[50] Thus, Self-dealing transactions may easily result in diversion of corporate asset, anytime the consideration of the exchange departs from market prices.[51] This kind of transactions/dealings which benefited only the corporate controllers while negatively affecting the asset of the company and ultimately endangering the minority shareholders is commonly known as Abusive/Unfair Corporate Self-dealing transactions.[52]

In contrast, it is important also to mention that Self-dealing is not always evil. Because, though corporate self-dealings involve "non-pro-rata distribution" (i.e. in economic terms to mean unfair distribution of assets among shareholders), it is not always the case as there are also self-dealings which are useful both to the company and ultimately to all shareholders.[53] This could be true despite the existence of conflict of interest, yet if negotiated at the arms-length market prices following both procedural and substantive requirements of the law. And, this kind of transactions can be called Legitimate/Fair Self-dealings.[54]

In sum, based on the value it add to the company and ultimately to the shareholders as a whole and according to the nature of self-dealing explained under the above two paragraphs we have two types of corporate self-dealing: Abusive/Unfair and Legitimate/Fair Self-dealings respectively. Normally, Legitimate/fair self-dealings are those dealings which are made as per procedural and substantive standards of self-dealings provided by law and/ or contract at an arms' length and

[49] See, Alessio M. Pacces, Supra note 11, p.189.
[50] See, Alessio M. Pacces, Supra note 26, p. 501.
[51] Ibid.
[52] See, Luca Enriques, Supra note 2, p.299.
[53] Ibid.
[54] Ibid.

advantageous to the company and the shareholders, while Abusive/unfair self-dealings are opposite to the former.

2.2.2. Self-dealing Transactions and Tunneling

In literatures, the term "self-dealing" is often used interchangeably with "tunneling" generally to mean the practice of extracting money or assets from the company to a dominant corporate owner, manager, or director. For instance, Simon Johnson et al. define "tunneling" as the "transfer of resources out of a company to its controlling shareholder (who is typically also a top manager)" and obviously it also includes transfers to managers who are not controllers.[55] They admitted that the term tunneling is coined originally to characterize the expropriation of minority shareholders in the Czech Republic (as in removing assets through an underground tunnel), to describe the transfer of assets and profits out of firms for the benefit of those who control them.[56]

On the other hand, on terms which are almost similar with the above definition of tunneling, Djankov *et al.* defined self-dealing as to include actions taken by individuals who control a corporation (managers, controlling shareholders, or both) to "divert corporate wealth to themselves, without sharing it with the other investors."[57] For them, examples of self-dealing include theft of a company's assets, taking corporate opportunities, excessive executive compensation, and self-serving financial transactions such as executive loans and equity issuance where it is made unfairly.[58]

Therefore, from the above explanations it is possible to say that self-dealing and tunneling can be considered as terms which can be used interchangeably to mean any activities that help the corporate controllers whether they are directors, managers or controlling shareholders to divert or expropriate the asset of the company by using different opportunities they have in the company as a result of their positions in the same. Here, it is clear that the corporate self-dealers are mainly the corporate controllers including directors or managers and controlling shareholders and related third parties in which those controllers has an interest.

And, the mechanisms by which the corporate controllers engage in corporate self-dealing is many-folds as we can grasp from the above discussions. As such, starting from the outright theft or fraud

[55] Simon Johnson et al., Supra note 45.
[56] Ibid, p.2.
[57] Djankov et al., Supra note 1.
[58] Ibid.

of the corporate wealth to transacting with the company in which they are controlling at non-arms-length transactions (i.e. a transaction not made objectively on the market price), expropriating different business opportunities to the company by transferring to themselves or other related third parties, paying themselves excessive compensations for their services to the company and diluting the shares of other shareholders in the company. In its broad sense of definition as it is explained above corporate self-dealing may goes to the extent not directly expropriating the asset of the company rather indirectly by making corporate re-arrangement including through merger, spin-off and etc. However, though each mechanisms of committing corporate self-dealing needs extensive discussion it is not the aim of this study, rather the main emphasis is on how the law has to respond to the corporate self-dealing transactions in general.

2.2.3. Self-dealing and Related Party Transactions

Though we cannot find formally established relationships between the two, many scholars are using them interchangeably and others treat the related party transaction as the most common form of self-dealing. For instance, Alessio M. Pacces used the two terms interchangeably through all text of his doctoral thesis while defining a related-party transaction as a transaction with someone who has a close and possibly privileged relationship with the company, including controlling owners or directors of the company, their immediate families and other companies that they control.[59]

Besides, the World Bank provides an example of related party transaction which are similarly provided as an example of self-dealing in different literature as mentioned above including sales of goods or services to the company at inflated prices or purchases from it at excessively low prices, loans to or from the company on advantageous terms, and even an outright transfer of company assets to the controlling party.[60]

On the other hand, in addressing the relationship between self-dealing and related party transaction, the thesis written on the title “Related Party Transaction in Financial Sector of Ethiopia” by Getachew Redae argues that the former is narrower than the latter and is included in

[59] See, Alessio M. Pacces, Supra note 26, p. 502.

[60] The World Bank Group (2006), Self-Dealing, Vice Presidency Note, No.312, P.1, available at, https://openknowledge.worldbank.org/bitstream/handle/10986/11176/377100VP03120Nenova1Hickey.pdf;sequence=1, retrieved on March 17, 2017.

the latter.[61] He said, this is because self-dealing mainly deals with the transaction between a company and its director(s), whereas related party transactions includes the transactions between a company and other related parties in addition to the transaction between a company and its director(s).

However, his argument doesn't hold water as the converse is also true since corporate self-dealing is not limited to the transaction between the company and its directors. Rather, in its strict sense of definition related party transaction is narrow than self-dealing and included under the latter as related party transaction can be limited to the situation where there is some contract or negotiation to buy and/ or sale goods and services between the related parties. However, as we have discussed above corporate self-dealing encompass different forms which can expropriate the wealth of the company even without involving any transaction between the company and its controller for instance through the corporate re-structuring, diluting of shares and etc.

Be this as it may, in the corporate governance literatures the related party transaction is not treated in its strict sense of terms and taken broadly as it can be used interchangeably with self-dealing as it is noted above and the writer also agree with this line of argument. Because, what matters should not be the existence or absence of the transaction or contract between the related parties to consider certain activities as self-dealing, rather the existence of conflict of interests between the two related parties (i.e. the company and its controllers or the company and other related parties of the controllers of the same), the manner in which such conflicts of interests are treated and the degree of influence by controllers to make some benefits for himself/herself from any dealings between the two should be considered. Hence, by accepting the term transactions (in its broader concept) as it mean actions or operations regardless of the existence of contract of sale, it is possible to accept corporate self-dealings as substitute to corporate related party transactions.

Thus, it is worth noting that in both corporate self-dealings and related party transactions, expropriation of corporate assets can be implemented through a very broad range of transactional techniques, provided that just two conditions are fulfilled.[62] The first is that the corporate controller has unrestrained discretion over the transaction and its financial terms. The second is that the

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[61] See, Getachew Redae (2013), The Regulation of Related Party Transactions in the Ethiopian Financial Sector: With Special Focus on Banks, (LLM Thesis, Addis Ababa University), p.17, available at http://etd.aau.edu.et/bitstream/123456789/1522/2/ALL%20IN%20ONE.pdf, accessed on January 1, 2017.

[62] See, Alessio M. Pacces, Supra note 26, p.502.

transaction is affecting the welfare of the corporation negatively, while enriching, at the end of the day, its controller. Here, if these two conditions are fulfilled it shows that the corporate controllers are engaging in Abusive/Unfair Corporate self-dealings and thus, the law has to interfere to prevent its commission or to deter such kind of corporate mal-practices. On the other hand, as we are going to see it under the role of laws in addressing the problems of corporate self-dealings, the law has to design the mechanisms to protect the Legitimate/Fair corporate self-dealings which can efficiently increase the value of the company and its shareholders despite the existence of conflicts of interests.

2.2.4. Self-Dealing and Insider Trading

In order to actually understand the relation of self-dealing and insider trading, first it seems better to define the concept of insider trading, sometimes called insider dealing. Yet, defining self-dealing again here is futile as this has done above. Accordingly, Insider trading has been defined generally to mean trading in the shares of a company for making a gain or for avoiding a loss by manipulation of prices by persons who are in the management of the company or are close to them, on the basis of undisclosed price sensitive information regarding the working of the company which they possess but which is not available to others.[63] In short, Insider trading occurs when individuals with potential access to material non-public information about a corporation buy or sell stock of that corporation.[64] Here, though not in detail it is necessary to see briefly what do material non-public information mean.

As such, Information become material when the possessed information is price sensitive information about a company and enables the person in its possession buys or sells shares in that company, and so obtains better terms in the contract of sale than would have been the case, had the counterpart been aware of the information in question.[65] On the other hand, information is considered non-public if it has not previously been disclosed to the general public through, for example, a press release or posting on the Company's website and is not otherwise available to the

[63] Sharma L. M., Amalgamations Mergers Takeovers Acquisitions: Principles, Practices and Regulatory Framework (1st edn, Company Law Journal, Taj Press, 1997), p.299.

[64] James H. Thompson (2013), A Global Comparison of Insider Trading Regulations, *International Journal of Accounting and Financial Reporting*, Vol. 3, No. 1, p.1

[65] Gower & Davies, Principles of modern company law (7th edn, London: Sweet & Maxwell 2003), p.751, as cited in A. A. Oluwabiyi (2014), A Comparative Legal Appraisal of the Problem of Insider Trading in Mergers and Acquisitions, *Frontiers of Legal Research, Vol. 2, No. 1*, pp. 1-15

general public.[66] Thus, Insider dealing on the basis of inside information has been identified as an action against the principle of equal access to information for all those who need such information to make investment decisions. However, by virtue of his being in charge of ultimate decision-making about the company management, the corporate controller has access to privileged information ahead of actual and potential non-controlling shareholders. Hence, trading the company's stock on the basis of this information may lead to easy profits at the expenses of outside shareholders.

For this reason, every country in the world with a major stock exchange including US and UK had made this practice illegal because of its potential to destroy public confidence in the stock exchange.[67] In Ethiopia also, though there is no formally established securities markets so far, as presently companies are selling shares to and buying from investors and the government is preparing and selling bonds to the society especially for the purpose of Grand Renaissance dam, the existence of insider trading is inevitable. Thus, the government has to prepare itself and plan to design suitable legal and regulatory frameworks to respond to the problem of insider trading that will be intensified with the development of securities markets and economic growth of the country in the future.

Now, it is the time to look at the contradistinctions between the two concepts and as we can grasp from the above explanation, insider trading is one form of self-dealing transaction. This is also evident from the definition of self-dealing provided by a scholar named Shapiro as "the exploitation of insider positions for personal benefit" where personal benefit is defined to include embezzlement or expropriation of funds, allocation of corporate contracts to businesses in which the insider has an interest, and the use of corporate resources for personal gain.[68]

However, it is noticeable that self-dealing is broad in scope while insider trading is specific as it is limited to indirect expropriation of the asset of the company only through illegal use of material non-public information, while self-dealing includes both direct and indirect transfer of the asset of the company to its controllers. Again, insider trading is limited to the expropriation of the securities markets including shares, bonds and other negotiable instruments of the company while self-

[66] Ibid.

[67] See Dignam, Alan and Lowry, John, Company Law (4th edn, Oxford University Press 2006), p.74.

[68] See, Elaine Henry et al., Supra note 36.

dealing is inclusive of all kinds of asset expropriation by the corporate controllers. This means, insider trading is included under the broad concept of self-dealing.

2.3. Approaches on How to Control the Problems of Corporate Self-dealings

Although there are several possible techniques to discipline corporate self-dealing, the following four principal approaches are provided below as they are often provided in literature as the main approaches available to answer the question what should be the role of law in addressing corporate self-dealing.

2.3.1. Prohibition Theory

Perhaps the simplest way of disciplining corporate self-dealings is to prohibit them absolutely as it helps to save all endeavors to prevent or deter any abusive self-dealing in the company law of a certain country. According to this theory, a society can prohibit transactions which involve conflict of interests' altogether and all dealings between a corporation and its controllers or any other entity these controllers control could be banned by law.[69] For instance, "(i)n 1880, the general rule in the US was that any contract between a director and his corporation was voidable at the instance of the corporation or its stockholders, without regard to the fairness or unfairness of the transaction.''[70] Therefore, it could be argued that historically any dealings which involve a conflict-of-interest was voidable and could be repudiated by the corporation, regardless of its terms or its desirability to the corporation at least in the US legal system. However, this general rule of prohibition was abandoned by the courts and the finding of an original prohibition rule on self-dealing in the US has recently been criticized as being inefficient and thus, self-dealing is allowed with some procedural and substantive standards[71] as it will be provided below in this study.

Concerning the legal system of UK with this regard, although UK company law refer to the prohibition rule, this rule has never been more than a default rule and parties were free to waive it, either by charter provision, or through stockholders' approval or ratification.[72] For this reason, it

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[69] See, Djankov et al, Supra note 1.

[70] See, Harold Marsh Jr (1966), "Are Directors Trustees?" *Business Lawyer, Vol.22,* p. 36. See also Note, 'The Fairness Test of Corporate Contracts with Interested Directors' in (1948) 61 *Harvard Law Review* 335, as cited in Luca Enriques, Supra note 2, p.303

[71] See, Norwood P. Beveridge Jr (1992), 'The Corporate Director's Fiduciary Duty of Loyalty: Understanding the Self Interested Director Transaction' *DePaul Law Review, vol.41,* pp.659–660.

[72] See, Luca Enriques, Supra note 2, pp.304-305.

was argued that though UK law was prohibitive of corporate self-dealing, self-dealing has never been prohibited in practice as such.[73]

The proponents of Absolute Prohibition theory submit that, absolute prohibition of self-dealing preferred for two principal advantages.[74] First, such a rule would be easy to apply since it avoids the need to perform complicated evaluations and it would be effective in preventing most of the inefficient deals. Secondly, the rule is preferable as it would remove the costs associated with fairness review, such as those generated by the expense of litigation on fairness issues. In practice, this approach is identical to a requirement of unanimous approval for transactions involving a conflict of interest as it eliminates the problem of conflicting interests and if the entire group consents, there is no risk of harm to any individual in the group.[75]

On the other hand, as there will be a significant number of self-dealing transactions which are efficient despite the presence of a conflict of interest both absolute prohibition and the requirement of unanimity voting become ineffective as they will exact too heavy loss of too many efficient transactions.[76] In case of unanimity requirement, a single negative vote would suffice to halt the transaction, regardless of whether opposition is the result of strategic holding out[77] or a bona fide mistake as to the merits of the deal. It implies that, an absolute prohibition or a requirement of unanimity is incompatible with the goal of maintaining the act of efficient transactions and is therefore too extreme to serve as a general solution to the problem.

It seems for this reason that, at present time, the theory of absolute prohibition of self-dealing transactions lacks acceptance, perhaps as it might prevent value-increasing transactions from taking place.[78] On the other hand, though it is not prohibited altogether some transaction-specific prohibitions of self-dealing (i.e. Selective Prohibition) can be observed in most of the legal systems. In particular, credit transactions in favor of directors are prohibited, with different

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[73] Ibid.
[74] Ibid.
[75] See, Zohar Goshen, Supra note 39, p.401.
[76] Ibid.
[77] Holding out is defined by Goshen as one form of strategic voting in which a voter who believes a transaction to be worthwhile nonetheless chooses to oppose it in an attempt to extract greater personal gains in exchange for her consent. See Zohar Goshen, Controlling Strategic Voting: Property Rule or Liability Rule? *South California Law Review, Vol.70,* p.741.
[78] Ibid.

exceptions and qualifications in many legal systems.[79] In Ethiopia too, it is similarly regulated under article 357 of the 1960 Commercial code of Ethiopia. Thus, it is possible to remark here that though absolute prohibition of corporate self-dealing is not preferable, selective prohibition of some inefficient transactions like loan to and from the corporation by the corporate controllers is possible to protect the interest of the company and the minority shareholders from unfair expropriation. However, it is worth mentioning here also that even the efficiency of outright prohibition of such transaction is questioned by some scholars like Luca Enriques saying that the prohibition of loan between the company and its controllers seems tenable only in case it is not secured.[80]

2.3.2. Non-intervention Theory

This is a theory in an opposite end with a theory of total prohibition against self-dealing transactions we have seen above. Non-intervention theory advocates for the no-action has to be taken against self-dealing and it recommend to leave the problem of self-dealing to the unconstrained forces of the market to resolve.[81] Its proponents argues that nonintervention allows market forces to generate appropriate solutions to self-dealing situations on an individual basis. However, this would be true only in a perfectly efficient market, the market in which there is no transaction costs.

In reality, however, markets are not perfect, and the efficiency level of a market depends on a function of the economic and legal conditions in a given jurisdiction,[82] especially in countries like Ethiopia where there is no developed markets. For example, unless the companies in a certain country provide necessary information about how to handle the case of self-dealing transactions in their company, the investors who want to invest in the company would incur costs to know and choose the companies which may provide protections. On the other hand, to curb this problem, companies may invest in publicizing the attributes of the protections they offer by internalizing the costs of keeping the investors informed.[83] Still however, investors would be expected to pay some costs as they would be required to process and evaluate the wide variety of protections and

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[79] Ibid.

[80] See, Luca Enriques, Supra note 2.

[81] See, Zohar Goshen, Supra note 39, p.404.

[82] Ibid, p.405.

[83] Ibid.

information that may be offered to them by the company. This shows the inefficiency of the markets to regulate the problems of corporate self-dealings effectively.

Thus, if a market is not sufficiently efficient, nonintervention will fail as an effective solution mainly due to costs of necessary information in the markets. Besides, to the dismay of this theory empirical evidences shows that virtually no society uses this approach as the temptation to ‘‘take the money and run’’ in an unregulated environment is just too great.[84] Hence, effective regulation of self-dealing has strong connection with tackling its problem and thereby leads to the development of capital markets as opposed to the Non-interventionist arguments.

2.3.3. Property Protection Rule (Approval by majority of the minority vote/Independent Directors)

Shareholder approval (the "majority of the minority vote") and independent directors/external appraisal ratification fall within a property-type protection.[85] According to this approach the performance of Self-dealing transactions is subject to the approval requirement by disinterested parties. In the work of Zohar Goshen it is known as the "majority-of-the-minority vote" theory and recognize only the approach in which the votes of the disinterested members of the group (i.e. shareholders) are relevant to determine the consent of all shareholders by excluding those shareholders with a conflict of interest from participating in the vote.[86] However, though the vote of disinterested shareholders is generally accepted as the genuine way of controlling corporate self-dealing,[87] the approval theory has to also include the system in which the board of directors is allowed to decide on the performance of self-dealing transaction by excluding the directors with a conflict of interest.[88] Because, what matters as per this theory should be that it requires operations potentially detrimental to the outside investors' (to Minority shareholders') claims to be directly or indirectly approved by the disinterested party.

For the proponents of this theory, the prohibition on conflict-of-interest voting has two primary benefits.[89] First, it prevents a self-dealer from imposing a transaction on an unwilling minority.

[84] See, Djankov et al, Supra note 1.
[85] See, Pizzo et al., Supra note 41, pp.3-4.
[86] See, Zohar Goshen, Supra note 39, p.402.
[87] See, Djankov et al., Supra note 1.
[88] Ibid.
[89] See, Zohar Goshen, Supra note 39.

Second, since such an approach is based upon consent, it is unnecessary to bring the transaction before the courts for an objective evaluation at the latter stage after the transaction has taken place.

Yet, this theory is not without limitations and it is inefficient solution in certain cases due to the existence of the threat of strategic voting which can prevent the performance of efficient transaction.[90] Hence, if some members of minority opting for their personal gain vote against the transactions (i.e. holding out), an efficient transaction may be lost as it either become burdensome on the interested self-dealer if the holding-out is increased unreasonably or he want to protect his reputation even in case of reasonable holding-out. As a result, since it is difficult to accept that all minority shareholders are free from the influence of corporate controller and this will likely prevent them to decide fairly for the interest of the company, the writer also do not agree with those who argue this approach would be efficient way of addressing the problems of corporate self-dealings.

2.3.4. Liability Protection Rule/Fairness theory/

Fairness theory is a theory in which the interested party in the Self-dealing transactions must demonstrate that the transaction is the product of "fair dealing" and reflects a "fair price."[91] In essence, it permits the self-dealer to vote but provides that these transactions will subsequently be examined by an independent body, typically the courts, on an objective valuation basis to determine if they meet certain standards imposed by law.[92] The theory allows the person with a conflict of interest to impose the transaction on the minority, but it also enables the minority to claim before the courts that the transaction is unfair. However, it does not ensure that the minority gets the best achievable deal, rather it is no more than a guarantee to the profits made by fair transaction (i.e. made at the arms' length) that might be expected of a transaction between willing buyers and sellers.[93] Ongoing disclosure and the enforcement of supervisory agencies and criminal sanctions are a direct expression of such a liability-protection rule.

Besides, it can be argued that a determination of the "objective" value of an asset is not an exact science since the court must base its decision on value assessments made by professionals who can be erred by the wrong reports of embezzlement from the interested self-dealers. Yet, despite the drawbacks of a system that relies on the courts and professional assessments of value, it is

[90] Ibid.
[91] Ibid, p.397.
[92] Ibid, p.403.
[93] Ibid.

difficult to get other means of determining the objective value of an asset.[94] Hence, it is possible to conclude that it is inevitable for the court to err while objectively measuring the fairness or otherwise of the transaction which made subjectively by the opportunistic self-dealers (often corporate controller) and imposed on the minority shareholders.

2.4. False Negatives and False Positives Problems

The concept of False Positive and False Negative in corporate Self-dealing is known as the "Type I/Type II error" paradigm that borrowed from statistical inference.[95] In economic analysis of law, the typical Type I error or false positive is equal to conviction of an innocent person, while the typical Type II error or false negative is considered as equal with an acquittal of a guilty person.[96] False Positive and False Negative paradigm are used by the scholars of law and economics believing that it is suitable to the assessment of legal policing of self-dealing.[97] Similarly, these concepts are used in this study to assess the efficiency of corporate self-dealing regulation under the Ethiopian Company law.

In the effective and strict regulation of self-dealing, it is incidental that the act of expropriation by the corporate controllers is occurred. Because, the minority shareholders can challenge the occurrence of self-dealing directly by using their rights to challenge the acts (governance strategies) or indirectly before court through legal strategies provided by the law. In this kind of strict regulation of self-dealing, it is believed that few abusive self-dealing (non-pro-rata distributions in economic sense of terms) can be occurred as the system can prevent or deter it effectively. Here therefore, there is a limited risk of the problem of false negatives (i.e. limited occurrence of expropriation and/ or few potential opportunistic self-dealers go unpunished).

However, in this strict regulation of Self-dealing where the minority shareholders have excessive rights to intervene in the discretionary power of the controllers, corporate controllers might have to relinquish valuable transactions (projects) involving conflicts of interests for fear of being held accountable. This would be the case even when those transactions are not abusive and have no purpose to unfairly divert the asset of the company they control which form the first example of

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[94] Ibid.

[95] See Alessio M. Pacces, Supra note 11, p.191.

[96] RD Cooter and TS Ulen, *Law and Economics* (Boston, MA, Addison-Wesley, 5th edn, 2008), 489–90, as cited in Alessio M. Pacces, Supra note 11, p.191.

[97] Alessio M. Pacces, Supra note 26, p.509.

the problem of False Positive.[98] Besides, strong shareholder powers may be used opportunistically by some investors, thereby undermining the commitment of managerial discretion to valuable firm-specific investments and long-term strategies, which is another example of False Positives.[99] It is the problem of false positive because, though the system seems to protect the right of shareholders by avoiding the occurrence of abusive self-dealing, it is not for it prevent many valuable transaction to the company and make innocent corporate controllers accountable only for they are transacting with the company for good.

Conversely also, a very sloppy kind of regulation against self-dealing would lead to just the opposite of False Positives.[100] Thus, though the corporate controller's ability to make profits through the exercise of managerial discretion would not suffer many restrictions in case of conflicts of interest to minimize the risk of false positives, the discretion should not allow him to divert those profit to himself instead of dividing them pro-rata (as per their share of ownership) with non-controlling shareholders. Meaning, if the discretion of corporate controller is high to the extent allowing that he would unfairly divert the proceed from the transaction with the company the problem of false negatives in which the system is acquitting the guilty or letting the abusive self-dealers go free will be created. Here, in the system of lax policy against self-dealing the minority shareholders may lack the way to challenge the abusive self-dealing as it may be considered as giving many discretion for the company controller is advantageous to the company and they may not commit abusive self-dealing. In reality, however, there would be many abusive self-dealing left without challenge in the name of attracting profitable self-dealing transaction and thereby create the problem of False Negative.

Therefore, in regulation of self-dealing transaction company law shall solve the problem of Type I and Type II errors (i.e. False Positives and False Negatives, respectively) as finding the right balance between managerial discretion and the constraints against unfair diversion of the asset of the company is the crucial question of a legal discipline of self-dealing. Though it is not easy task to come up with workable solution of the errors, the law should be designed to balance the two extreme type of problems. On one hand, the law should strive to minimize intervention with the exercise of the corporate controller's discretion to allow the corporate controller's to enter into

[98] Alessio M. Pacces, Supra note 11, p.191.
[99] Ibid.
[100] Ibid.

related-party transactions when the potential gains of these transactions to shareholders as a group exceed the expected value of diversion, while it would be equally possible to prevent inefficient related-party transactions when the potential benefits to the corporation are less than the benefits to the self-dealers.[101] To realize this, though there is no one size fits all kind of regulation which can perfectly avoid the above problems everywhere, establishing of independent directors whom their mandate is limited to controlling corporate self-dealing and similar pecuniary expropriation of the company is accepted both in different jurisdictions and literature as important mechanisms to ensure the efficient regulation of self-dealing as we will see it in the coming section and last part of next chapter, respectively.

2.5. Experience of Selected Countries

2.5.1. The United States: Focus on Delaware State Corporate Law

The law towards investor protection of the United States are considered as one of the countries providing outside shareholders with a very high level of protection from the corporate controller's misbehavior, though it cannot be the highest in the world.[102] This is a result of its unique combination of rules and enforcement, of federal (securities) regulation and state (corporate) laws, and of institutional factors that are both legal and non-legal.[103] Besides, in the US, this discipline of controlling corporate self-dealing has a number of special players including: [104]

- the Securities and Exchange Commission (SEC) – the oldest, and perhaps still the most aggressive, securities regulator in the world;
- Delaware courts – the leading jurisdiction in American corporate law;
- corporate lawyers – after executive directors, perhaps the second most important player in US corporate governance; and
- The financial press – the ultimate activator of reputational constraints in the corporate America.

As it is not the aim of this study and not that much relevant in Ethiopia (at least until formal securities markets established) we focus only on the corporate law of the countries leaving the

[101] Ibid.
[102] See Alessio M. Pacces, Supra note 26, p.548.
[103] See Paredes, T.A. [2004], *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law isn't the Answer*, in WILLIAM AND MARY LAW REVIEW, vol. 45, 1055-1157, as cited in Alessio M. Pacces, supra note 26, p.548.
[104] See Alessio M. Pacces, Supra note 26, p.549.

securities markets regulation. Accordingly, here we focus on the corporate law of Delaware State of US, which is widely recognized as the most significant jurisdiction for corporate law purposes and has adopted a fairness test as a default to govern self-dealing transactions.[105] For Delaware, a default fairness test is the right solution to the problems arising from self-dealing transactions due to various characteristics of the U.S. markets and the Delaware judicial system. Firstly, Adjudication costs are low, both because of an efficient judicial system, and because of the parallel activity of market mechanisms. Second, negotiation costs are also low due to the presence of institutional investors and the efficiency of the capital markets. Meaning, as the Delaware courts possess unique expertise in appraising the value of transactions and in applying corporate law with the efficiency, reliability, and speed crucial to a dynamic business world and there are sophisticate institutional investors that hold a large segment of minority shares and the business community is sensitive to business reputation with regard to the management of corporations, applying fairness test by the court will solve the problem of self-dealing efficiently. Hence, by adopting this rule, Delaware avoids the need to hold a formal vote on every self-dealing transaction and requires courts to rule on only a minority of disputed cases.

To see some cases of Delaware courts, in *Kahn v. Lynch Communication Systems, Inc.*,[106] the Supreme Court declared entire fairness the "exclusive standard" for assessing mergers in which a controlling shareholder "stands on both sides" of the transaction.[107] However, this case did not answered the extent to which entire fairness applied to mergers involving a controlling shareholder on only one side of the deal and subsequent cases have also questioned the effect that properly employed procedural safeguards (*i.e.*, special committees and majority-of-the-minority shareholder approval conditions) should have on the standard of review for controlling shareholder transactions.[108] The matter is solved in case of *In re John Q. Hammons Hotels Inc. Shareholder*

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[105] Delaware State is chosen here for one thing, though it cannot represent the experience of all states in the US it is accepted by the literature as the most important jurisdiction for the corporate governance studies and, for another thing, it is difficult to go through the experiences of all states of the US, in the given time. Thus, though it is not possible to conclude the corporate governance experience of the US from the Delaware State corporate governance, the paper selected Delaware State at least to see the experience of a state which significantly regulate the issue of corporate self-dealings specifically. See Robert Charles Clark, Corporate Law (1986), p.166; See also, Zohar Goshen, Supra note 39, p.426; Alessio M. Pacces, Supra note 11, p.203.

[106] 638 A.2d 1110 (Del. 1994), as cited in Bradley R. Aronstam and David E. Ross (2010), Retracing Delaware's Corporate Roots Through Recent Decisions*, Delaware Law Review, Vol. 12, No.1,* p.13.

[107] Ibid, p.1117.

[108] See Bradley R. Aronstam and David E. Ross, Supra note 106, p.14.

Litigation,[109] where the Delaware Supreme Court held that, in the absence of both a properly empowered and functioning special committee and a majority of the minority condition, entire fairness applies to a merger involving a controlling shareholder that does not stand on both sides of the underlying transaction but competes with the minority shareholders for a fixed amount of consideration and will have a continuing interest in the post-merger entity.

At the same time, however, parties are free to shift to an approval test through their contract and thus, Delaware courts allow parties to contract around the fairness rule and condition a deal upon approval of the majority of the disinterested minority.[110] The approval of a self-dealing transaction by a majority of disinterested shareholders can affect the way the Delaware courts scrutinize a contested transaction in two ways.[111] On the one hand, where a controlling shareholder engages in self-dealing, the "entire fairness" test remains the standard by which the transaction is judged, but the burden of proof to show that the transaction is unfair passes to the party attempting to block its performance.[112] On the other hand, when the interested party is a director or manager without a controlling interest in the corporation, the transaction is measured against the business judgment rule, an entirely different standard, which is extremely deferential to the interested party.[113]

Because of the existence of these two systems, many scholars believe Delaware's system to be a complicated, incoherent, and unexplainable system of rules. However, some also argued the particular characteristics present in Delaware law show that it has developed a coherent and very efficient solution to the self-dealing problem by establishing a liability rule as a default.[114]

In theory, under a property-rule approach which we have seen above under chapter two of this thesis, there is no need to determine whether the transaction is fair, since the dis-interested party who is mandated to approve the dealing can fend for itself. However, the stated rationale behind the Delaware courts' refusal to deviate from the fairness test in a controlling owner's self-dealing, even when a disinterested minority is secured, stems from procedural concerns.[115] For example, a

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[109] Ibid.
[110] See Zohar Goshen Supra note 39, p.427.
[111] Ibid.
[112] *See* Kahn v. Lynch Communication Sys., 638 A.2d 1110 (Del. 1994), as cited in Zohar Goshen, Supra note 39, p.427.
[113] *See* Michelson v. Duncan, 407 A.2d 211 (Del. 1979), as cited in Zohar Goshen, Supra note 39, p.427.
[114] See Zohar Goshen, Supra note 39, p.427.
[115] Ibid.

controlling shareholder may exploit his position to distort the voting, whether by threatening the minority with future reprisals or by abusing the wide discretion which proxies afford him.[116] Besides, as we have seen some where above, there will be opportunistic minority who want to further their personal gain and the property-rule approach may prevent efficient self-dealing transaction. Indeed, the courts have kept the fairness test in order to provide themselves with sufficient ability and flexibility (which are absent under the business judgment rule) to tackle these procedural risks.

This implies the superior ability of Delaware's judiciary to cope with the problem of Type I and Type II errors in policing abusive self-dealing and, more in general, with the discretion-accountability tradeoff in corporate governance.[117] The fact that Delaware courts allow a controlling shareholder to shift the burden of proof to the contending shareholder upon receiving the support of the majority of the disinterested shareholders provides an additional efficient means to control self-dealing. Because, in the first place the system allows the controlling person to choose from two alternatives either to make the deal and bear the burden of proof that the deal is fair; or to make the deal with majority-of-the-minority support and shift the burden of proof to the party opposing the deal. In the first case, the controlling person could approve a deal on the lower side of the surplus, but he will be obliged to prove its fairness if litigated in the court by contending parties.

Hence, to change the burden of proof of the fairness of the transaction the controller can negotiate with the majority of the minorities at somehow higher price than it can make under the fairness test which do not require approval at all. Besides, the controller is benefited from avoiding the burden of proof in the court and from lower price of transaction that would be high in the system of purely approval by the disinterested parties rule. Here, the negotiating power of the minority is limited by the knowledge that even if their support is not given, the controlling person can still make the deal and bear the burden of proof that it is fair. Nevertheless, the price offered to the minority must be higher than it would have been had their support not been sought.

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[116] *See* Citron v. E.I. du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990), as cited in Zohar Goshen, Supra note 39, p.428.
[117] See Alessio M. Pacces, Supra note 26, p.549.

On the other hand, from the side of the disinterested parties also, this option would be efficient as it give them the negotiating power to fix the price of transaction and prevent them from the risk of wrong decisions by the court in purely fairness test due to the err in appreciation of the exact market price of the transaction especially in the jurisdiction with inefficient Judicial system. Therefore, shifting the burden of proof provides the market with the incentive to seek the support of the majority of the minority, thereby reducing the need for judicial judgment on the value of the deal. In sum, the US legal system at least in the Delaware corporate governance with respect to the regulation of self-dealing is basically categorized as the regulatory strategy as it basically allow shareholder litigation, unlike the UK system which based on governance strategy which empower shareholders to take necessary measures to enforce the regulation.

2.5.2. The United Kingdom

Though the United Kingdom shares many characteristics with the United States in terms of its capital markets and its economic and social environment in being extremely active and well developed, it is generally acknowledged that the British discipline of related-party transactions is significantly different from the American one.[118] However, unlike in the US, the balance between false positives and false negatives of the regulation of corporate self-dealing in the UK is determined by the bite of the enforcement mechanisms which not based on private litigation but, rather, on a combination of public enforcement and (threat of) ouster by institutional investors.[119]

Indeed, like that of US, the default rule followed in the United Kingdom is a fairness test and thus, a controlling shareholder is free to vote his shares at a shareholders meeting called to approve a transaction in which he has a personal interest.[120] Even a director who is also a shareholder may vote on a transaction in which he is interested when the law requires that such transaction receive the prior approval of the shareholders.[121] However, in contrast to its American counterpart and against this freedom to vote with a conflict of interest, section 459 of the company law provides

[118] See Kraakman et al., The Anatomy of Corporate Law: A Comparative and Functional Approach, (Oxford University Press 2004), pp.101-130; See also, Djankov et al., Supra note 1.

[119] Alessio M. Pacces, Supra note 26, p.549.

[120] Paul L. Davies, GOWER'S PRINCIPLES OF MODERN COMPANY LAW, (6th ed. 1997) 707, as cited in Zohar Goshen, Supra note 39, p.430.

[121] Ibid, p.708.

that minority shareholders can present a petition of "unfairly prejudicial" transaction,[122] and courts have wide discretion in deciding upon the appropriate remedy.[123]

However, while section 459 theoretically seems to provide adequate protection for minority shareholders in self-dealing transactions, given the United Kingdom's inefficient and ineffective courts, in practice, liability-rule protection has not provided adequate protection due to high adjudication costs.[124] Among other things, lack of requisite expertise and mechanics of corporate deal-making in UK judicial system and its judges strict adherence to the principle of stare decisis are the main factors that attributes to high adjudication costs and thereby inefficient solution of fairness test in regulating corporate self-dealing in UK.[125]

Generally, the above historical explanation of company law of United Kingdom shows that before the Companies Act of 2006, there was no need of disinterested approval and the interested director was entitled to vote. In the presence of full disclosure, it was only possible to attack the transaction on the basis of the duty of good faith. After Companies Act of 2006 however, most conflicted interest transactions can be just approved by the board of directors provided that full disclosure of the conflict of interest is made[126] and votes of interested directors do no longer count for a valid board approval.[127]

Yet, shareholder approval is still essential in the British discipline of conflicted interest transactions because of three main reasons.[128] Firstly, it cannot be entirely opted out as company law makes it compulsory for certain transactions, most notably substantial property transactions and payments for loss of office.[129] Secondly, significant related-party transactions entered into by

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[122] *See* Companies Act 1985 (UK), section 459(1) (UK). Section 459(1) provides: A member of a company may apply to the court by petition for an order under this Part on the ground that the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interest of its members generally or some part of the members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.
[123] Companies Act 1985 (UK), section 461(2).
[124] See Zohar Goshen, Supra note 39, p.431.
[125] Ibid.
[126] Davies, P. (2002a), INTRODUCTION TO COMPANY LAW, Oxford University Press, pp. 174-176, in Alessio M. Pacces, Supra note 26, p.573.
[127] Companies Act 2006 (UK), Section 175.
[128] See Alessio M. Pacces, Supra note 26, p.573.
[129] See Companies Act 1985 (UK), Sections 320-322 and Companies Act 2006 (UK) Sections 190-196 ('substantial property transactions').

quoted companies are anyway subject to the different, and in a sense stricter, procedure of shareholder approval prescribed by the Listing Rules of the Financial Services Authority (FSA).[130] Thirdly, only shareholder approval (or ratification) can safely relieve directors from liability, at least in those circumstances in which ratification is allowed.[131]

This may suggest that the British approach to abusive self-dealing leaves little margins for false negatives, but possibly allows for high risk of false positives. However, though it is essentially correct, this conclusion can be qualified based on how the controlling shareholders behavior is policed in spite of their being in control of the general meeting, the limited standing to sue derivatively of non-controlling shareholders, and how directors are nonetheless prevented from engaging in diversionary conduct.

Accordingly, in case of the first qualification, even though both interested directors and interested controlling shareholders used to face no limitation in casting their vote at the general meeting, courts have always maintained that breach of the duty of loyalty was not ratifiable.[132] In addition, in the presence of non-ratifiable breaches, the procedural hurdles of derivative litigation in the UK are not applicable provided that the wrongdoer is in control of the company.[133] Finally, the Listing Rules which are strictly enforced by both the FSA and institutional investors – do not allow either directors or 'substantial' shareholders (i.e., those who control 10% or more of the voting rights) to vote on significant transactions with their related parties.[134]

In fact, shareholder ability to sue derivatively has been limited for over a century by the *Foss v. Harbottle* ruling, which gives standing against directors only to the company and its competent bodies, unless a fraud on the minority has been committed and the wrongdoer is in control of the company.[135] This principle has been heavily debated but never overruled, until the Companies Act of 2006 took it over and thus, derivative suits are now allowed when there is a *prima facie* case of

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[130] See Listing Rules (UK), Section 11 (Related Party Transactions).

[131] Davies, P. [2002a], Supra note 126, pp.191-196, in Alessio M. Pacces, Supra note 26, p.573.

[132] Cook v. Deeks [1916] 1 AC 554, PC (shareholders cannot ratify fraud or illegality). See also Smith v. Croft (No 2) [1988] Chapter 114 (individual shareholders may not sue for breaches that can be ratified by a majority of shareholder independent of the wrongdoer), discussed in Davies, P. [2002a], Supra note 126, pp. 225-226.

[133] Farrar et al., (1998), FARRAR'S COMPANY LAW, Butterworths, pp. 435-441.

[134] Based on Listing Rules, Section 11.1.7, related parties and their associates cannot vote on the shareholder resolution approving the transaction. According to Listing Rules, Section 11.1.4, a substantial shareholder qualifies as related party. 'Substantial shareholder' is defined in Listing Rules, Appendix 1, relevant definitions.

[135] Foss v. Harbottle (1843) 2 Hare 461, in Alessio M. Pacces, Supra note 26, p.76.

breach of any of the director's duties (including an objective duty of care!), subject to permission by the court and unless the transaction has been ratified by disinterested shareholders.[136]

Indeed, a feature of British law when it comes to self-dealing is the availability of a number of venues for public enforcement. A certain proportion of shareholders may request, for instance, the Secretary of State to institute a proceeding of investigation of the company's documents, or to appoint an inspector for reviewing the company's affairs, when they suspect of director's misconduct.[137] Even more importantly, non-transparent directors would never be forgiven by institutional investors, and likewise by the business community at the London Stock Exchange.[138] And, more than any form of legal liability, directors fear ouster from that community since the former would be forthcoming, and it is uncertain at any rate, while the latter is immediate and not appealable. As a result, transactions featuring abusive diversion of the company's asset are very unlikely to be put forward, for they will never pass the direct or indirect scrutiny of institutional investors.[139]

As institutional investors do not like to sue and they are too much committed to the company for a plain 'exit' strategy as they often prefer having directors they are dissatisfied of ousted from the board.[140] Other non-controlling shareholders may behave worse and try to sue the controllers. However, the absence of an expert judiciary and, above all, of contingent fees (of which the British 'conditional fee' arrangement is not a substitute) makes it unlikely that director's liability will ever become a major driver of corporate governance in the UK since non-controlling shareholders and their agents lack incentives to start suits against the controllers.[141] This is fortunate, as director's liability would probably lead to an explosion of false positives otherwise and it shows that the

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[136]See, Companies Act 2006 (UK), Sections 260-264.

[137] See especially, the powers conferred upon the Secretary of State by Section 432 (appointment of inspectors) and Section 447 (investigation of company documents) of Company Act of 1985. This part of the Companies Act has not been repealed by the Company Act of 2006, which only amended the discipline of company investigations by enhancing the powers the Secretary of State of moderately changing the investigation procedure. See Companies Act 2006, Part 32, Sections 1035-1039.

[138] See, Armour, J. and Skeel, D.A, *Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation* (2006) ECGI Law Working Paper No. 73/2006, available at www.ssrn.com and www.ecgi.org.

[139] See, e.g., Black, B.S. and Coffee, J.C. Jr. [1994], Hail Britannia: Institutional Investor Behavior under Limited Regulation, *Michigan Law Review*, vol. 92, pp. 1997-2087.

[140] See Alessio M. Pacces, supra note 26, p.577.

[141] See Davies, Supra note 126, pp. 249-251.

policy of controlling abusive self-dealing in the UK is “governance based,” as opposed to the “transaction based” approach of the US.[142]

This makes monitoring by independent directors, rather than director’s liability, a most promising venue for improving the discipline of related-party transactions in the UK. For this reason, some scholars argue that Independent directors as an instrument for governance (as opposed to a safe harbor for the corporate controller’s liability) are a British, not an American invention. British law keeps on maintaining the self-regulatory character of this institution, but there is no reason to doubt that it is a source of credible commitment for corporate controllers.[143]

2.5.3. Germany

To begin with, German companies typically show a number of distinctive features. These include a two-tier (management and supervisory) board with co-determination between shareholders and employees on the supervisory board, creditor monitoring arising from long-term lending relationships, concentrated ownership structures with substantial cross-holdings and banks among the pivotal shareholders.[144] Moreover, in Germany the definition of corporate governance explicitly mentions stakeholder value maximization, while the Anglo-American system mostly focuses on generating a fair return for the shareholders.

The main point of departure, however, is the separation between the management board (*Vorstand*) and the oversight body, the supervisory board (*Aufsichtsrat*). This roughly corresponds to a distinction between inside and outside directors; however, pursuant to German law, these two sets of directors have significantly different duties and work in different management bodies.

Having said this on general features of companies in Germany, when we come to issues of corporate self-dealing transactions, the members of the management board manage the corporation's business and are subject to a wide-ranging obligation not to compete with the company.[145] And, transactions between a member of the management board and the corporation

[142] See Kraakman et al., Supra note 118, p.68.
[143] See Davies, Supra note 124, pp. 200-206.
[144] See Peter Burbidge (2003), "Creating High Performance Boardrooms and Workplaces, European Corporate Governance in the Twenty First Century", *Economic Law Rev*. Vol.28, p.651.
[145] See, Stock Corporation Act 2010 (Germany), Section 88. (Translation by Norton Rose Group (2011)).

may not be approved by the interested manager or even by the entire management board, but only by the supervisory board, to which law assigns this specific duty.[146]

Because traditionally most German corporations are controlled by a family, a controlling majority shareholder, or at least a number of large shareholders,[147] German corporate law has focused less on the regulation of conflicts between shareholders and managers and more on those between controlling and minority shareholders. Given this nature of the agency problem, German corporation law (*Konzernrecht*) addresses, *inter alia*, the conflicts of interest that may arise in connection with transactions between a corporation and its controlling shareholders.[148] Accordingly and consistent with the two-tier board structure, control relies on the Supervisory Board, and the law requires Supervisory Board approval for specified self-dealing transactions.

However, compared to other jurisdictions, legal barriers to self-dealing are found to be relatively low in Germany as it is demonstrated in a widely cited comparative study, Djankov et al., which found that legal protection against self-dealing is low by EU standards.[149] These empirical results are consistent with suggestions in the literature that the Supervisory Board is ineffective in controlling self-dealing, given the incentives faced by its major constituent groups.

On the other hand, as in the Anglo-American legal systems, German legal doctrine contains a duty of loyalty that members of a management body owe to their corporation, and the violation of which creates liability to the corporation for damages.[150] The violation of the duty of loyalty will create strict personal liability. For example, transactions among affiliated companies must be described in an annual report on control relationships that must be prepared by independent auditors. This report is designed to ensure that transactions among affiliates take place at arm's length prices.

Further, German courts have once held that shareholders hold a duty of loyalty to each other. For example, in the seminal *Linotype* case of 1988, the 96 percent corporate shareholder had initiated a shareholder resolution to dissolve the firm in order to integrate its profitable business into its own. The Federal Supreme Court nullified that resolution, because it found that the majority

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[146] See, Stock Corporation Act 2010 (Germany), Section 112.
[147] S*ee* M.Becht and E.Boehmer, "Ownership and Voting Power in Germany," in F. Barca & M. Becht (eds.), The Control of Corporate Europe, (2001), pp. 128-153.
[148] Stock Corporation Act 2010 (Germany), section 311.
[149] Jürgen Odenius *(2008),* Germany's Corporate Governance Reforms: Has the System Become Flexible Enough?*, IMF Working Paper,* No. 08/179.
[150] Ibid.

shareholder had violated its duty of loyalty by using its voting right to obtain a special advantage to the detriment of the minority.[151] In another famous case however, the German Supreme Court refused to hear the complaint from the small shareholder on the grounds that the controlling shareholder did not owe any duties of good faith or loyalty to the minority shareholders.[152] In this case, Volkswagen (i.e. the controlling (75%) shareholder of Audi), bought out a small equity stake of a minority shareholder in Audi for USD 145 per share. The price was based on a valuation provided by Volkswagen (or VW). Two weeks later, VW bought out a very large (14%) stake in Audi from the British-Israeli Bank for USD 220 per share. Despite this facts, the court ruled that VW was under no obligation to reveal its negotiations with the British-Israeli Bank because such a revelation might have negatively affected the valuation of VW's shares.[153]

This shows, in Germany, the current Corporate Governance Code focuses only on the "conflicts of interest" issue between members of the Management Board (*Vorstand*) and of the Supervisory Board (*Aufsichstrat*) are bound by the enterprise's best interests and thus, they may not pursue personal interests in their decisions or use business opportunities intended for the enterprise for themselves.[154] Consequently, while the management board normally has the authority to enter into contracts on behalf of the company, this is not the case in dealings with any of the board members.[155] German law is known for its special rules on corporate groups that were introduced in the 1965 reform. It distinguishes between contractual groups and de facto groups. A contractual group is created by a control agreement, under which instructions to the controlled firm become permissible even if they are to the benefit of the controller or other firms within the group.[156] In a de facto group, the controlling undertaking may not instruct a controlled firm to enter into disadvantageous transactions unless any disadvantages are compensated for; the compensation must be determined in the same financial year at the latest.[157]

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[151] BGH 1.2.1988, II ZR 75/87, BGHZ 103, 185; see also BGH 22.6.1992, II ZR 178/90, NJW 1992, 3167 (discussing the duty of loyalty in the context of a capital increase).
[152] Simon Johnson et al., Supra note 45, p.8.
[153] Ibid.
[154] See German Corporation Law, section 311 Stock Corporation Act (*Aktiengesetz*), which prohibits the controlling enterprise from using its influence to induce a subordinate enterprise to enter into a transaction that is disadvantageous to the subordinate enterprise without being given compensation.
[155] Stock Corporation Act 2010 (Germany), Section 112.
[156] Stock Corporation Act 2010 (Germany), Section 308.
[157] Stock Corporation Act 2010 (Germany), Section 311.

In sum, in Germany there are no procedural rules comparable to other jurisdiction seen above addressing transactions with other related parties, though a transaction can be void under general principles of civil law in cases of collusion (where directors and third parties consciously cooperate to the harm of the firm).[158] The courts have been relatively restrictive in their interpretation of the provision described above, and have typically not applied it to other self-dealing situations by analogy (with the exception of cases of "economic identity" between the director and a third party). For example, one court of appeals refused to apply the provision to a situation where one company's director held a significant stake in another firm to which he granted a loan in his capacity as a director of the former.[159]

2.5.4. France

In France, all transactions in which a director or, since 2001, a shareholder with more than 10 percent of the voting rights', or the company controlling such shareholder, has a direct or indirect interest must be authorized ex ante by the board of directors and ratified by the annual shareholder meeting, following a special report by the statutory auditors *(commissaires aux comptes).*[160] The interested party must inform the board of directors about the considered transaction[161] and abstain from voting both within the board and at the shareholders meeting.[162] However, these rules do not apply to "current transactions entered into at normal conditions", which only have to be disclosed by the interested party to the chairman of the board, who must then provide a list of such transactions to the board and to the statutory auditors.[163]

French law also prohibits some forms of self-dealing which are deemed to be too dangerous. This is the case of loans to managers or directors or guarantees for their benefit.[164] However, loans to shareholders, whether individuals or legal entities, are not prohibited. In fact, this is similar with what is provided under article 357 of the 1960, commercial code of Ethiopia.

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[158] See generally Eberhard Schilken, in *J. von Staudingers Kommentar zum Birgerlichen Gesetzbuch, sec.* 167, comments 93 et seq., 100 et seq.

[159] OLG Saarbriicken, 30.10.2000, 8 U 71/00, AG 2001, 483 = NZG 2001, 414, as cited in Pierre-Henri Conac et al. (2007), Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy, ECFR, Vol.4, p.500, available at, http://ir.lawnet.fordham.edu/faculty scholarship, accessed on January 10, 2017.

[160] Commercial Code 2006 (French), Arts L. 225-38 and L. 225-40.

[161] Commercial Code 2006 (French), Art. L. 225-40.

[162] Commercial Code 2006 (French), Art. L. 225-40.

[163] Commercial Code 2006 (French), Art. L. 225-39.

[164] Commercial Code 2006 (French), Art. L. 225-43.

As in all the above jurisdictions, in France also standards are in place that restrict directors' ability to manage the company in the interest of dominant shareholders alone and the ability of dominant shareholders to exercise control powers to the detriment of other shareholders. First, legal scholars and courts hold that directors in all countries owe their company a duty of loyalty that require them to disregard or even oppose dominant shareholders' attempts to self-deal.[165] Second, whether implicitly or explicitly, the civil law countries grant shareholders a right to be treated equally by the corporation, which might prevent it from granting unjustified benefits to its dominant shareholders.[166]

France also provide for "abuse of majority powers" *(abus de majoriti*) doctrines that restrict majority shareholders' freedom to vote as they wish at general meetings. In fact, they may not exercise their voting rights in such a way as to pursue their own self-interest (and not the company's) to the detriment of fellow shareholders.[167] In France, case law considers that there is an abuse of majority if a majority shareholder votes against the "corporate interest" of the company, in order to pursue her own personal interest and to detriment of the minority shareholders.

A few special rules on intra-group transactions apply in France also, but no general or partial regime like in Germany can be found in the statutes. For instance, the law allows loans to directors that are legal entities, while it prohibits them when granted to directors who are natural persons.[168] Further, a special provision allows cash pooling within groups, which otherwise would be prohibited by banking laws to businesses other than banks.[169] While there are no other special rules that allow treating intra-group transactions less severely than other forms of self-dealings who are natural persons, within the context of criminal law, French courts have developed the doctrine that allows a "group defense."[170]

[165] See Pierre-Henri Conac et al. Supra note 159, p.501.
[166] Ibid.
[167] Ibid.
[168] Commercial Code 2006 (French), Art. L. 225-42.
[169] Article L. 511-73, French Monetary and Financial Code.
[170] See Maggy Pariente (2007) 'The Evolution of the Concept of "Corporate Group" in France', ECFR, Vol. 4, p. 317, as cited in Pierre-Henri Conac et al, supra note 159, p. 505.

Lastly, it is important to see a well-known case of self-dealing/tunneling (SARL Peronnet case) in France as it is documented in Johnson et al.[171] In this case, SARL Peronnet is a French company controlled by the Peronnet Family which later established a new company, SCI, solely owned by family members. SCI bought some land and took out a loan to build a warehouse and then, leased the warehouse to SARL Peronnet and used the proceeds to repay the loan. In 1999, SAICO, a minority shareholder of SARL Peronnet, sued the Peronnet Family. SAICO claimed that the Peronnet Family expropriated minority shareholders of SARL Peronnet by giving the leasing contract to an entity (namely, SCI) that was related to the controlling shareholder while it was possible for SARL Peronnet to find a cheaper deal (for example, the proposal to build a warehouse by SAICO).

As documented by Johnson et al., a French court ruled against SAICO and held the transaction between SCI and SARL Peronnet valid under French civil law and the ruling was on two grounds.[172] First, the court held that the decision by Peronnet to pay SCI to warehouse its products was not against the social interests as evidenced by the fact that sales of SARL Peronnet expanded during the period of the lawsuit. Second, it held that SARL Peronnet expansion had benefited SAICO as well.

Thus, depending on the above case, though it is difficult to guess on how a court would rule on this case under a common law system without an independent valuation on the fairness of the leasing contract, let us see how the plaintiff (a minority shareholder), had more difficulties to successfully challenge the controlling shareholder under a civil-law system than under a common law system. We will see this from two scenarios. Firstly, the French court applied a higher standard of proof in conflict of interest situations. It could thus be argued that the decision to build a warehouse through SCI was not solely intended to benefit the controlling shareholders (i.e., the Peronnet Family), and had a legitimate business purpose that also benefited the minority shareholders. Under French law, this was sufficient to rule against SAICO, while in the U.S. or U.K., this would not have prevented the plaintiff from proving the existence of conflict of interest situation in this case. And secondly, the French court relied on statutes rather than fairness to regulate self-dealing transactions. Because, as it was reported in Johnson et al., “The court took no

[171] Simon Johnson et al., Supra note 45, pp.7-8.
[172] Ibid.

interest in the questions of whether the creation of SCI, and the prices it charged SARL Peronnet for the use of the warehouse, were fair to SAICO and other minority shareholders."[173] Thus, as long as SAICO (the minority shareholder) has not suffered an actual loss, the law protected the Peronnet Family. However, had it been in the U.S. and U.K., courts would have been very suspicious of the conduct of the Peronnet Family unless it could demonstrate that the leasing contract was fair through an independent valuation of the transaction.

2.5.5. Kenya

Before liberalization of Kenya's economy in the 1990s which institutionalized privatization of government corporations, accountability in the public sector was almost absent and this lack of accountability in the public sector was replicated in the private sector which in turn make nepotism and corruption pervasive.[174] However, after the most significant attempt to reform corporate law which end up in various Bills, Kenya eventually enabled to have the recent comprehensive Companies Act in 2015[175] (here in after, Kenya Companies Act). More significantly, the Act protects shareholders from the excesses of directors in numerous ways, the most outstanding ones being enhancement of, and additions in, the Duties of Directors and their enforcement; and making clear provisions for the derivative action.

For the purpose of this thesis however, the writer prefer to see different provisions of the Act which deals with the duties of Directors in relation to corporate self-dealing/related party transactions. Accordingly, the Act imposes numerous duties on directors of companies which the end effect of such provisions is to empower shareholders not only sanction certain actions by directors before they are taken, but also to speak out against actions taken against their interests.

More particularly, the Act impose the duty to avoid conflicts of interest or a situation where the director has, or can have, a direct or indirect interest that conflicts, or may conflict, with the interest of the company particularly with regard to exploitation of any property, information or opportunity. It does not matter whether the company could take advantage of the property,

[173] Ibid.

[174] Jacob K. Gakeri (2013), Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities, *International Journal of Humanities and Social Science, Vol. 3, No. 6,* p.97.

[175] See Companies Act 2015 (Kenya), *Kenya Gazette Supplement No. 158 (Acts No. 17).*

information or opportunity.[176] In connection with this duty, the Act impose two specific duties to tackle the problem of self-dealing transactions.

Firstly, directors are required to avoid a conflict between their interests and those of the company.[177] This means that if a director is in any way interested in a transaction or arrangement that the company has entered into or is about to enter into, that director has a duty to declare the interest and extent of his interest to the other directors; and where the company is a public company, to the shareholders of the company. In any case where the transaction is for an amount, or goods or services, exceeding 10% of the value of the company‘s assets, then the declaration must in addition be made to the shareholders in a general meeting.

The second important duty is to obtain shareholders' approval before entering into certain transactions, which include:

a. Transactions where a director of the company or of its holding company acquires or is to acquire from the company a substantial non-cash asset;[178]
b. Transactions where the company acquires or is to acquire a substantial non-cash asset from a director;[179] Notably, transactions or arrangements entered in contravention of these provisions are voidable at the instance of the company;
c. Loans, quasi-loans[180] or guarantees to directors of the company or of its holding company[181]. If the director is a director of the company´s holding company, the transaction also needs to be approved by a resolution of the members of the holding company;
d. Directors' long-term service contracts. These are service contracts where the director‘s employment is guaranteed for a period exceeding, or that could exceed, two years;[182]

[176] Companies Act 2015 (Kenya), Section 146.
[177] Companies Act 2015 (Kenya), Section 151.
[178] Companies Act 2015 (Kenya), Section 158. For these purposes, an asset is a substantial non-cash asset if its value; Exceeds 10% of the company‘s asset value and is more than Kenyan shillings (here in after, Kshs.) 5,000,000; or Exceeds Kshs. 10,000,000.
[179] Companies Act 2015 (Kenya), Section 158.
[180] Under the Kenya Companies Act, a quasi-loan is a transaction under which a creditor agrees to pay (or pays) an amount for the borrower, or the creditor agrees to reimburse (or reimburses) expenditure incurred by another party for another person (also a borrower) on terms that the borrower will reimburse the creditor or in circumstances giving rise to a liability on the borrower to reimburse the creditor.
[181] Companies Act 2015 (Kenya), Section 164.
[182] Companies Act 2015 (Kenya), Section 157.

e. Insider credit transactions by public companies. A company may not enter a credit transaction as creditor or guarantor for the benefit of its director(s) or a director(s) of its holding company unless the transaction has been approved by shareholders;[183]
f. Payments to directors as compensation for loss of office;[184]

From the above discussions in this section, it may be argued that the Act indirectly gives shareholders the power to participate in or influence such transactions by requiring prior approval where shareholders can also question certain aspects of the deal. Besides, these specific duties outlined above are backed by criminal sanctions for non-compliance. Indeed, it is one of the salient features of the Act to provide the heavy penalties imposed on directors for offences related to compliance with the provisions thereof.[185] Therefore, there is no doubt that the above discussion will provide important lessons for Ethiopia to impose clear and specific duties on the directors to effectively tackle abusive self-dealing transactions at least where the directors of the company is to participate in self-dealing transactions.

2.5.6. South Africa

To begin with, the corporate governance in South Africa (SA, here in after) was institutionalized by the publication of the King Report of 1994 which aimed at promoting corporate governance by recommending standards of conduct for boards and directors of listed companies, financial institutions and other public sector enterprises.[186] The King Committee on corporate governance was formed with the support of the Institute of Directors South Africa (IoDSA). It was later replaced by the King Report of 2002 which contained a voluntary code of corporate practice and conduct. The third King Report was released in 2009 and this third revision was necessitated by the enactment of the new Companies Act of 2008[187] (here in after, SA Act) which incorporated many of the principles embodied in the previous King Reports. The King Codes have continued to play a significant role in promoting effective corporate governance and high standards of governance in South African companies. However, the King III recommendations are not

[183] Companies Act 2015 (Kenya), Section 167.
[184] Companies Act 2015 (Kenya), Section 182.
[185] The penalties include elements of monetary fines and imprisonment for varying terms depending on the seriousness of the offence. See generally, Jacob K. Gakeri, Supra note 174.
[186] Institute of Directors in South Africa, *Executive Summary of the King Report 2002 King Committee on Corporate Governance* (Institute of Directors in South Africa 2002) https://www.saica.co.za/Portals/0/documents/executive_summary_king11.pdf, accessed on June 10, 2017.
[187] Republic of South Africa Companies Act (2008), Government Gazette No 34239. (Here in after, SA Act)

prescriptions (i.e. it does not adopt a "one size fits all" approach to corporate governance), instead it formulates guidelines of best practice for optimizing corporate performance and accountability in the interests of shareholders and the broader economy.[188]

On the other hand, the SA Act provides that a director must at all times disclose any personal financial interest of himself or any related person to the board or shareholders and, a director is required to disclose the nature and extent of the financial interest before and at the board meeting where the matter is to be considered and he must not take part in the consideration of the matter.[189] Such a transaction can only be valid if it is approved by the other directors or ratified by an ordinary resolution of shareholders in the prescribed manner and after full disclosure of material information has been made.[190]

Besides, though it does not define what the best interests of the company are and it has no provision as to what considerations should be taken into account, the SA Act provides that a director has a duty to act in the best interests of the company which is important to tackle the problems of self-dealing.[191] However, South African company law has importantly incorporate the business judgment rule as part of the statement on the duty to act in the best interest of the company.

The business judgment rule is found in section 76 (4) of the SA Act and relates to the director's duty to act in the best interests of the company and with care, skill and diligence. According to this rule, a director will be protected from allegations of breach of the duty to act in the best interests of the company and with care, skill and diligence in relation to a matter where that director has:[192]

a. taken reasonably diligent steps to become informed about the matter;
b. either had no conflict of interest in relation to the matter or complied with the rules on conflict of interests; and
c. Had a rational basis for believing, and did believe, that his decision was in the best interest of the company.

[188] Linda Muswaka, Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis (2013)*, International Journal of Humanities and Social Science, Vol. 3, No. 7,* p.93
[189] Companies Act 2008 (SA), Section 75 (5).
[190] Companies Act 2008 (SA), Section 75 (6).
[191] Companies Act 2008 (SA), Section 76 (3) b.
[192] Companies Act 2008 (SA), Section 76(4).

In general, the business judgment rule is the important procedural standard that can be used as a protection for directors against liability imputations. Because, as we can grasp from the above provision as long as directors are acting in good faith, with sufficient information, and not subject to a self-dealing conflict of interest, they should be free from having their business decisions second-guessed by minority shareholders and judges. Therefore, the Ethiopian share company law must take a lesson from this provision and incorporate the business judgment rule which importantly protect the rights of directors who act according to the law from allegations by an opportunistic shareholders who can abuse their rights of litigation.

2.6. The OECD Principles of Good Corporate Governance

The OECD Principles were first agreed and issued by OECD member states in 1999 after the occurrence of 1997 Asian financial crisis,[193] and the principles have been revised in 2004. They are nonbinding standards, principle based and an outcome oriented. Nevertheless, the OECD principles are designed to provide a specific guidance for policy makers, regulators and market players in their endeavor to improve their legal, regulatory and institutional framework for sound corporate governance.[194] Consequently, they can be benchmarked and adapted whether or not a given country's legal framework is common or civil law and irrespective of the company's ownership structures and level of economic development. Generally, as it is also important to measure the regulation of self-dealing transactions in the share company law of Ethiopia, the principles of OECD which can be divided in to six major parts are discussed briefly as follows:[195]

1. Ensuring the Basis for an Effective Corporate Governance Framework; the principles advocate that the legal, regulatory and institutional framework of a country that shapes the corporate governance of companies should be adjusted with the new developments of markets.[196] Consequently, the principles recommended policy makers to formulate an adequate and comprehensive legislative response.

[193] OECD (Organization for Economic Cooperation and Development) Principles of Corporate Governance (April 2004), available at http://www.oecd.org/home/0, 3675,en_2649_201185_1_1_1_1_1,00.html, last accessed March 15, 2017.

[194] Policy Brief: The OECD Principles of Corporate Governance (2004), No.1, available at http://www.oecd.org/dataoecd/41/32/33647763.pdf, last accessed April 20, 2017.

[195] OECD, Supra note 158.

[196] Ibid, p.2.

2. The Rights of Shareholders and Key Ownership Functions; The second areas of the principles insist on an inherent ownership rights of shareholders should be promoted and protected by corporate governance framework.[197] As per the principle, the inherent rights of shareholders include secured ownership registration, free transfer of shares, obtain all material and reliable information timely and regularly, participate and vote at shareholders meetings and partake in dividends.[198] Correspondingly, the Ethiopian share company law provisions show the basic rights of shareholders including the right to ownership registrations, right to information, right to participate and vote in the meetings of shareholders, right to transfer or sale shares and participate in the profits or proceeds of the company. These ownership rights of shareholders are similar to the OECD Principles. However, except the rights to share the profits of the company, the other basic ownership rights of shareholders are not properly articulated. Thus, this in adequacy will be discussed in chapter three especially with regards to the problems of corporate self-dealings.
3. The Equitable Treatment of Shareholders; The third areas of the principles state that the corporate governance framework should equitably treat all shareholders' rights, including minority and foreign shareholders, and in case of violation they should have the right to obtain effective remedies.[199] Treating shareholders equitably builds investors' confidence because they understand that their investments within the companies are protected from misuse by corporate insiders. It also strongly advocates that minority shareholders should be protected from abusive behaviors of insiders trading and abusive self-dealings, including controlling shareholders transaction with the company.[200] Similarly, any transactions made by board members and executives directly, indirectly or on behalf of third parties are required to be prior approval of boards.[201] In case of violation of these basic ownership rights, the principle maintains minority shareholders ex-post right to institute derivative or class actions unless such rights are abused. Besides, as such activities of controlling shareholders are identified as impediments of the development of capital and financial markets, the OECD Principles III (B) called for policy makers to prohibit such

[197] OECD Principles II.
[198] OECD Principles II, A.
[199] OECD Principle III.
[200] OECD Principle III, B.
[201] OECD Principle III, C.

activities and fill the gaps. Hence, the share company law has to provide legal protections to minority shareholders in two ways. In one hand, impose fiduciary duties on controlling shareholders. On the other hand, require review of their transactions with the company by independent directors coupled with full disclosure and fair accounting treatments.[202]

4. The Roles of Stakeholders in Corporate Governance; The fourth areas of the principles urge that corporate governance frameworks should address the concerns of stakeholders provided by laws or contractual agreements.[203] The principles dictate that the long term sustainability of companies depends on the outcomes of teamwork that integrates different resource providers inter alia investors, employees, creditors and suppliers. They also assert that the rights of these stakeholders provided by the law or contractual agreement should not only be respected but also in case of violations they should be fully compensated.[204]
5. Disclosure and Transparency; These areas of the principles states corporate governance frameworks should assure that the disclosure of information is made timely and accurately on all relevant issues regarding internal governance of the company. The principles recommend disclosure should incorporate but not limited with information like: the financial and operation results (the balance sheet, profit and loss accounts and the cash flow statements); objectives of the company; major ownership structures and voting rights; boards and senior managements remuneration policy; boards selection process, qualification, their independence and directorship to other company; related parties transactions; matters on employees and stakeholders; corporate governance structures; procedures and policies, and how they are implemented.[205]
6. Boards Responsibilities; The last areas of the principles calls for boards to strategically direct the company, effectively supervise managements and accountable to shareholders and the company.[206] The principles are designed to apply to all board structures and advocate boards should perform "in a fully informed basis, in good faith, with due diligence and care," and in the best interest of the company and shareholders.[207] This requirement

[202] OECD: '*Related Party Transactions and Minority Shareholder Right'* (2012) 27 OECD Publishing at *http://dx.doi.org/10.1787/9789264168008-en* , retrieved on March 2, 2017.
[203] OECD Principle IV.
[204] OECD Principle IV, A and B.
[205] OECD Principle V, A.
[206] OECD Principle VI, P.
[207] OECD Principle VI, A.

imposes two fiduciary duties on the boards: the duty of care and duty of loyalty. We will deal with this duties under chapter three of this thesis while analyzing the standards of self-dealing transactions in the share company law of Ethiopia.

Generally, there is no doubt that the above listed major OECD principles have relevancy to improve share companies' corporate governance in Ethiopia. However, the contribution of these principles to tackle the problems of corporate self-dealing transactions will be seen in detail in Chapter three of this thesis while analyzing the adequacy of share company law of Ethiopia in regulating self-dealing transactions.

CHAPTER THREE

MEASURING THE ADEQUACY OF SHARE COMPANY LAW PROVISIONS OF ETHIOPIA IN REGULATING SELF-DEALING TRANSACTIONS

In this chapter, efforts will be made to deal with what constitutes a definition for self-dealing transactions in Ethiopia, whether or not there is a requirement of disclosure, approval or ratification of self-dealing transactions, whether or not the principle of arm's length is available in Ethiopia, the enforcement methods in case of abusive self-dealing transactions in general and in financial sectors in particular.

3.1. An overview of Self-Dealing Transactions in the Share Company Law of Ethiopia

For clear understanding of the concepts in this thesis and before directly analyzing the adequacy of the share company law with regards to the regulation of self-dealing transactions from the three major factors (i.e. Disclosure, Standards and Enforcement as will be provided in the next section) identified to assess the adequacy of regulations, it is logical first of all to briefly discuss the overall approaches and definitions of self-dealing transactions under our laws. Accordingly, the following sections will provide an overview and definitions of self-dealing both under the 1960 commercial code of Ethiopia in general and under the financial sectors in particular.

3.1.1. Definitions and Approach of Self-Dealing Transactions in the 1960 Commercial Code of Ethiopia

To begin with, as explained under the introduction part of this thesis, defining the concept of self-dealing transactions has multi-faceted importance. However, the existing laws in Ethiopia do not clearly contain definition of self-dealing transactions though some laws including Commercial Code of Ethiopia and some laws in the financial sector contain some concepts of self-dealing transactions. Particularly, article 356 of the Commercial Code is about dealings between a company and its directors. The relevant sub-articles here read: "(1) any dealings made directly or indirectly between a company and a director shall receive the prior approval of the board of directors and notice shall be given to the auditors; and (2) Approval and notice under sub-art.1 shall be required in respect of any dealings made between a company and another concern where one of the directors of the company is owner, partner, agent, director or manager of such concern."

From the above provisions it is self-evident that the legislature tends to regulate the self-dealings between the company and its directors only. However, the literatures and the experience of other jurisdictions as we have seen in chapter one and two of this study shows that self-dealing is not limited to the relationships between the company and its directors, rather it can occur between the company on the one hand, and influential managers, controlling shareholders and third parties with whom these persons have an interest on the other hand. Therefore, article 356 of the commercial code of Ethiopia shall be revised to include all potential self-dealers that can engage in abusive self-dealing and as a result, expropriate the asset of the company. This is important to protect the interest of the minority shareholders, creditors and the company itself. In this regard, though it is not yet ratified, the new draft Commercial Code of Ethiopia in its Article 356(6) has included extensive list of parties that have to be considered as related parties of the company and any dealings between the company and the former has to be treated as self-dealings and hence, has to be approved by the board of directors.[208]

On the other hand, article 357 of the commercial code is particularly concerned with the prohibition of loans to company directors. This provision reads: 1) Directors of a company other than bodies corporate may not borrow money from the company, obtain an overdraft in current account or have any obligation guaranteed in respect of business transacted with third parties; 2) The provisions of sub-article (1) shall not apply in respect of day to day business of a company which carries on banking business. Though the title of this article looks prohibition of loans to company directors, it should be noted that the prohibition is not specific to loan because, it also applies to getting an overdraft in current account and to guaranteeing any obligation in relation to business transactions with third parties. In addition, the above prohibitions are limited to natural person company directors so that it does not apply to body corporate directors of a company. Finally, the above prohibitions, be it natural person or body corporate director, will not be applicable where the company is a banking business company in so far as the above transactions; loan, giving

[208] They include: Directors, Managers, Auditors, a shareholders holding above 2% of the capital of the company on the one hand, and their relative in consanguinity or affinity on the other hand, subsidiary and affiliate companies, advisors of the board members and managers, and other related parties that are mentioned in the Memorandum or Articles of Association. Similarly, there are extended definition of related parties with the commercial banks including a shareholder, officer of the banks and their spouses or first degree relatives in consanguinity or affinity, if they transact with each other to be regulated by the laws of self-dealing or related party transactions provided in the banking sector. For example, see, Article 3.7 of Directives No.SBB/53/2012.

overdraft in current account or guaranteeing the obligation, is in the normal course of business. The rationale of this exception seems to up lift unnecessary burdensome from the day to day activities of the banking business and not to prohibit efficient transactions between the related parties in the sector. Yet, the detail analysis of this issues will be provided in the coming sections.

One thing that should not be left unsaid with regard to the definition of self-dealing transaction is that, in addition to providing for extensive potential self-dealers (related parties) that can engage in self-dealing transactions, it is necessary to provide for clear forms of self-dealing transactions to identify what kinds of transactions if involved in by related parties are considered as self-dealing or not. In this regard, as extensively discussed in the preceding chapters of this study forms of self-dealing transactions includes executive perquisites, excessive compensation, transfer pricing, appropriation of corporate opportunities, self-serving financial transactions such as directed equity issuance or personal loans to insiders, and outright theft of corporate assets. In the share company law of Ethiopia however, it seems that article 356 of the commercial code is providing the general guidelines in which 'any dealings' between the company and the directors should be treated as forms of self-dealing except those normal transactions between the company and its clients. However, this method of providing for forms of self-dealing is too general and will not be efficient in the regulation self-dealing transactions.

Similarly, as we will see below in the next sections, the laws of financial sectors mainly recognize loan transactions between the related parties as the main forms of self-dealing transactions by leaving aside many other forms of self-dealings that the potential self-dealers in the sectors can engage in, including purchase or sale of assets and services, lease, renting/hiring and many other forms of self-dealing transactions. This in turn obviously render the regulation of self-dealing transactions in the financial sectors inefficient.

Therefore, rather than focusing on specific kind of transaction (i.e. loan) as the case in the laws of financial transactions or simply including all kinds of transactions as forms of self-dealing transactions as done in the commercial code of Ethiopia, the law has to provide clear guidelines on what kinds of transactions are subject to the regulation of self-dealing transactions. For instance, in the company laws of many sample countries we have seen in chapter two of this thesis including that of UK, the regulation of self-dealing transactions is applicable differently on the transactions

which exceed certain amount of considerations, not on any dealings between the company and its controllers.

3.1.2. Definitions and Approach of Self-Dealing Transactions in the Laws of Financial Sectors of Ethiopia

When we come to the regulation of self-dealing transactions in the financial sector of Ethiopia, self-dealing transactions is literally known as related party transactions.[209] As such, to start from the banking business sector, the definition of related parties in banks is provided under article 3.7 of Directives No.SBB/53/2012 which defines a related party to a commercial bank in two ways. On the one hand, a related party to a commercial bank shall mean "A shareholder, a director, a chief executive officer or a senior officer of that commercial bank and/or the spouse or relation in the first degree of consanguinity or affinity of such shareholder, director, chief executive officer or senior officer," and on the other hand, "A partnership, a common enterprise, a private limited company, a share company, a joint venture, a corporation or any other business in which the shareholder, the director, chief executive officer or senior officer of the commercial bank and/or the spouse or relation in the first degree of consanguinity or affinity of such shareholder, director, chief executive officer or senior officer who has a business interest as shareholder, director, chief executive officer or senior officer, owner or partner."

The definition in this Directive indicates that a shareholder can be one source of related party, but, the same Directive makes it clear that there is a threshold for shareholders to be considered as related party. Specifically, article 8 of Directives No.SBB/53/2012 provides that only those shareholders of a commercial bank with holdings of 2% or more of the commercial bank's subscribed capital shall be treated as related party and shall be subject to the provisions of this Directive. As per article 3 of Directive No.SBB/30/2002, the threshold was holdings of 5% or more of the subscribed capital of the bank. However, this directive is amended by Requirements for Persons with Significant Influence in a Bank Directives No.SBB/54/2012 (hereinafter called Directives No.SBB/54/2012). Accordingly, article 2.6 of Directives No.SBB/54/2012 defines an

[209] In fact, as the term "any dealings…." Under article 356 of the commercial code are taken as equivalent to "any transactions", any transaction between the company and its director who are related parties to each other is a self-dealing and hence, a related party transaction. Besides, where there is a transaction between a company and another entity where a director of the company is also owner, partner, agent, director or manager of the entity, the transaction is considered as related party transaction in that the company and the entity are related.

influential shareholder as “a person who directly or indirectly holds two percent or more of the total subscribed capital of a bank.” The implication of the above threshold is that not all shareholders can be considered as related party and that the scope of the directive with regard to shareholders is limited to those shareholders with holdings of 2% or more of the commercial bank’s subscribed capital. Conversely, shareholders of a commercial bank with holdings less than 2% of the subscribed capital will not be regarded as related party and will not be subject to the provisions of this Directive.

Hence, as per the above Directives shareholders who own more than two percent (2%) of the capital of the company (the bank) is subjected to both the procedural and substantive requirements to engage in self-dealing transactions while, those shareholders who own less than 2% of shareholdings are not. This implies, the laws in the banking sector differently from the provisions of commercial code provide for the case where the shareholders are treated as related party to the company and subjected under the regulation of self-dealing transactions. Thus, though such kind of provisions which regulate how the controlling shareholders who are not necessarily become directors in the company has to be controlled if they engage in self-dealing transactions, it is unnecessarily missing from the commercial code and other laws of financial sectors.

On the other hand, contrary to the banking sector, due attention is not given to the regulation of self-dealing transactions in the insurance companies in Ethiopia.[210] However, the Licensing and Supervision of Insurance Business Directive No. Sib/1/1994 (hereinafter called Directive No. Sib/1/1994) contains some issues of related party and related party transactions in the Ethiopian insurance sector. For instance, it has some relevant provisions such as on the definition of related parties though it simply defines related parties as referring to “directors, founders, principal officers, employees and other businesses in which they have direct interest.” As a result, it ignore other related parties mentioned in the case of banking business, for instance, the relatives of related parties with whom the directors of the company can engage indirectly in self-dealing transactions. However, as these and other potential self-dealers has to be regulated in order to effectively tackle the problems of self-dealing transactions, the definition of related parties in the regulation of this sector also needs modification.

[210] For example, there is no specific Directive dealing on the regulation of Self-dealing or related party transactions in the Ethiopian insurance companies so far.

Lastly to see the regulation of self-dealing transactions in the Micro-finance sector of the country, the Micro- Financing Business Proclamation No. 626/2009 has no provisions clearly dealing with the regulation of related party and/or related party transactions in the microfinance institutions. Yet, the gaps in the law of Micro-finance sector can be filled easily and the discussion on the banking sector can equally applicable for the issues of corporate self-dealing transactions in the former. Because, article 28(1) Proclamation No.626/2009 importantly states that "Banking business laws shall, mutatis mutandis, be applicable to micro financing business with respect to matters not covered by this Proclamation." Thus, it can be argued that the banking laws including Directives No.SBB/53/2012 and Directives No.SBB/62/2015 which are more relevant to the self-dealing transactions shall be applicable to microfinance institutions with regard to the regulation of self-dealing transactions, taking the necessary adjustments to microfinance institutions.

Generally as we will see it below in detail, even if they are helpful, the above laws still do not make clear the whole concept of self-dealing or related party transaction and thus, this thesis will provide further analysis and some incites in the following sections.

3.2. Examining the Regulation of Self-dealing Transactions in the Share Company Law of Ethiopia

In order to effectively and efficiently manage the problems of self-dealing transactions, we have to adopt the approach that the government has to move beyond laissez-faire (i.e. the strategy of no public involvement at all) and regulates the contracting framework, but leaves its enforcement to private parties.[211] This part of literature has recently concluded that, in order for the shareholders protection to be effective, law should not only make it easier for shareholders to litigate self-dealing but it also should empower them to review it.[212]

With this in mind, the regulation of self-dealing transactions in the share company law of Ethiopia will be analyzed from the following three important major factors identified to assess the effectiveness of self-dealing transactions as explained in the methodology part of this thesis.

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[211] See, Djankova et al., Supra note 1, p.38.

[212] See Alessio M. Pacces, supra note 11, p.178.

3.2.1. Disclosure

3.2.1.1. Disclosure in Share Company Law of Ethiopia in General

To begin with, it is generally agreed that corporate disclosure is the principal means of ensuring good corporate governance as it help to know all what is going in the company which in turn helps to check whether the company is using its resources as per its purpose of establishment.[213] Besides, it is the guarantee for protection of the interests of shareholders, creditors, governments and other stakeholders as the disclosure in the company clarify the status and all good and evil issues of the company. In line with this, to show the importance of disclosure, Gilson remarks that an optimal substantive standard, even when it is backed by an efficient enforcement process, would have no possibility of being implemented in the absence of "knowledge of violations."[214] Thus, it is possible to argue that extensive and effective disclosure requirements are essential for shareholders to exercise their ownership rights and for regulators to detect and fix malpractices within companies.

However, it is submitted that in Ethiopian corporate governance framework context, disclosure and the transparency of companies are neglected and almost impossible at the current situation.[215] For one thing, the financial disclosure requirements provided under 419(1), 446, 447 and 448 of the commercial code failed to comply with international financial reporting standards and best practices.[216] The financial reports required by these provisions only cover balance sheets and profit and loss accounts. They neglected other important components of financial reports (for instance, companies' cash flows and income statements, and any equity changes, recognized gains or losses statement).[217] Similarly, non-financial disclosures are very limited and only included publishing the name, nature, capitals, head office and the place of the meetings in the commercial newspaper as per articles 392(1) and 396 of the commercial code. These non-financial disclosure provisions missed the basic elements of disclosure standards. These includes, companies' ownership structure and voting rights, related parties' transactions, companies' objectives and potential risk factors,

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[213] See, Fekadu Petros Gebremeskel, Ethiopian Company Law, (2nd Edn, 2016), p.241.

[214] See, R.j. Gilson (2006), "Controlling Shareholders and Corporate Governance: Complicating the Taxonomy" *Harvard Law Review, vol. 119*, p.1653, as cited in Alessio M. Pacces, Supra note 26.

[215] See Fekadu Petros Gebremeskel, Supra note 8, p.2.

[216] See OECD Principles V (B&C).

[217] Reports on Observance of Standards and Codes Ethiopia (Commissioned Report 2007), p.6, available at http://www.worldbank.org/ifa/rosc_aa_ethiopia.pdf, last accessed on 21 March, 2015.

corporate governance structures, procedures and policies and how they are implemented.[218] However, such disclosures are vital for investors to decide whether or not to invest in a particular company.

Moreover, the share company law provisions had loopholes to require auditors to apply established accounting and auditing rules and standards. It also failed to require independently audited financial reports. Further, even company's auditors have no established accounting and auditing rules and standards in the country to apply in their auditing functions.[219] Unless independently audited and prepared based on established accounting and auditing rules and standards, it is hardly possible to expect that the financial statements truly and fairly represents the company's financial position and performance.

To see the regulatory frameworks of corporate disclosure in general, the commercial code of Ethiopia incorporated different disclosure requirements in its different articles including:

- Arts. 309(1)(c) and 318; accurate information about the company under formation has to be included in the prospectus that has to be published and disclosed to the public
- Art. 323; obligation to deposit Memorandum of Association and Article of Association to Trade Minister or other registering authority
- Art. 331(3-5); obligation to disclose the register of shareholders to the requesting shareholders without charge and/or to any third party up on payment
- Arts. 359-361; obligation to disclose the register of directors and their shareholdings to the shareholders and inspecting authority
- Art. 375; reports to be made by the company Auditors to the Shareholders about their duties and comments and recommendations on the work of directors
- Arts. 406, 417, 422, and 427; rights of shareholders to inspect documents at all times and some days before general meeting, extra-ordinary meeting and/or special meetings.
- Art. 461; publication of the balance sheet approved by the meeting.
- Art. 462(2); publication of resolutions of amendment to the Memorandum of Association and Article of Association

[218] See OECD Principles V, (A) (2-8).
[219] Ibid, p.12.

- Arts. 484 and 494; report by auditors on the proposal made by directors to reduce the capital of the company and publications of minutes on the decisions about the reduction of capital of the company.
- Art.504; deposit of the final balance sheet prepared and signed by auditors and liquidators at the dissolution period.
- Art. 521(2); report to be made by private limited company.

Though most of the above provisions are not directly related to the disclosure requirements in corporate self-dealing transactions, the discussion of those provisions which have relevancy in the disclosure of corporate self-dealing will be provided as follows. The first and most important disclosure requirement which is provided under the general corporate governance but indirectly relevant to the disclosure of corporate self-dealing is provided under Art. 406 which provides for the rights of shareholders to inspect documents[220] at all times and, Arts. 417, 422, and 427 that provides for the rights of shareholders to inspect documents during fifteen days preceding general/ordinary meeting, extra-ordinary meeting and special meetings, respectively. Particularly, the rights of shareholders to inspect and/or take copies of reports submitted or to be submitted by the directors and by the auditors to the meetings provides important disclosure requirement that can inform and empower the shareholders to challenge the commission of abusive self-dealing transactions, if any. However, as we will see it in the next part which deal with disclosure requirement in corporate self-dealing transactions specifically, the main problem that render this right ineffective is that there is no detail procedures that require all material information of self-dealing transactions that should be included in the reports by the directors and auditors.

Second, art.331 (3-5) require the company to disclose all the name of shareholders and the amount of their shareholdings in the company for those who request it. This is important disclosure which helps to identify controlling shareholders from non-controlling shareholders, if any. Yet, there is no clear requirement of disclosure of transfer of shares which enable certain shareholders to become a controlling shareholders under Ethiopian share company law. In addition, the offering of additional new shares in article 469(5) or debt securities provided in articles 429-433 of the

[220] Documents allowed to be inspected and/or take copies by shareholders include: on one hand, under article 406 and 417, balance sheets and profit and loss accounts; reports submitted by the directors and by the auditors to the meetings; and minutes and attendance sheets of these meetings, and on the other hand, under article 422 and 427 the text of resolutions to be proposed or of the auditors' report to be submitted to the meetings.

commercial code failed to require financial reports to be prepared based on established accounting and auditing standards and audited by independent auditor.[221]

Even, in the banking sector of the country also the new Banking Business Proc. no.592/2008 has no provision which require to disclose the information about an influential (controlling) shareholders. Though art.10 (3) of the same proclamation require that any transfer of shares which can make a person an influential shareholder must be approved by the NBE, there is no requirement to disclose this information to the shareholders and third parties. However, it is worth mentioning that requiring the disclosure of controlling shareholders helps the existing shareholders to decide correctly whether to stay in or leave the company and the potential shareholders to invest or not in the company as it inform them who is going to control the company in the future and thus, can expropriate the asset of the company through abusive self-dealings.[222] With this respect, the OECD principles of good corporate governance require that the shares held by shareholders must be disclosed if it exceeds certain percentage of the capital of the company in addition to disclosure of the special voting rights which enable him to control the company directly or indirectly, the transactions among shareholders, major shareholdings through joint holdings and etc.[223]

Thirdly, provisions from arts. 359-361 require to disclose information about the company directors and managers with their amount of shareholdings. However, necessary information about the directors and shareholders which help to adequately regulate the problem of self-dealing is not required to be disclosed except that of loans and guarantees to the directors.[224] Among other things, full name of the directors and managers, full name of their spouses (if married), their place of birth and other necessary information which help to identify third parties with whom they have interest will help to prevent the occurrence of abusive corporate self-dealing transactions. Because, for one thing, this disclosure is an important mechanism to prohibit insider trading[225] which can be committed by the directors and managers using the material non-public information. Again, full disclosure of information about the directors and managers may disclose the amount of the shares those persons has held in the company and this in turn helps shareholders and the public to know

[221] Commercial Code 1960 (Ethiopia), art. 469(5).
[222] See, Fekadu Petros Gebremeskel, Supra note 213.
[223] OECD (2004), p.51.
[224] Commercial Code 1960 (Ethiopia), art. 361(2).
[225] For detail explanation about the meaning of insider trading please refer back the chapter two of this thesis.

the status and fate of the company. If the directors and managers are buying the shares in the company, it may imply that the company is on the right track of development while, if they are selling the shares they own in the company increasingly it may send the message that the company is getting worse. Generally therefore, disclosure of information about the directors and managers will help the shareholders to control the activities in the company.

Besides, though it provide for the functions and duties of the auditors, the commercial code of the country has not incorporate any information about auditors of the company. However, auditors has the opportunity to expropriate the asset of the company especially if they are closely related with other corporate controller like directors and managers. Therefore, to prevent the abusive self-dealing in the company all information needed to be disclosed by the company's directors and managers has to be similarly disclosed by the auditors and any supervisors of the company. Furthermore, as per art. 344 of the commercial code, information about joint holdings of the company which is required to be disclosed if one company own above ten percent of shares in another company to enable the Trade Minister could decrease the holding is not sufficient. Because, this fact has to be made publicized for all other interested third party than restricting the disclosure requirement at Trade Minister only, to effectively prevent the harm that will occur as a result of unfair joint share holdings.

3.2.1.2. Disclosure in Case of Corporate Self-Dealing Transactions in General and under the 1960 Commercial Code of Ethiopia

To start with, disclosure in case of self-dealing transactions should be made in a way that ensures investors understand how those transactions can affect the whole company and the shareholders.[226] Accordingly, in deciding on what to disclose in case of self-dealing transactions, companies should give regard to the context in which the related party transaction occurs. Particularly to investors, high quality information disclosure requirements give them confidence in the reliability of financial reporting. In turn, this is a great asset in conducting business because it is argued that "without investor confidence, markets cannot flourish."[227] Conversely, there is a wide recognition

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[226] Australian Securities and Investments Commission: "Regulatory Guide 76: Related party transactions," March 2011, p.33, available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg76-300311.pdf/$file/rg76-300311.pdf , last accessed on March 25, 2017.

[227] See S. P. Kothari: "The Role of Financial Reporting in Reducing Financial Risks in the Market," Sloan School of Management, Massachusetts Institute of Technology, p.91, available at, https://ideas.repec.org/a/fip/fedbcp/y2000ijunp89-112n44.html, accessed on May 25, 2017.

that the absence of transparency in the transactions will enhance the occurrence and prevalence of the abusive self-dealing transactions.[228] It seems by recognizing these factors that, Principle V.A.5 of OECD provides that disclosure should include, but not be limited to, material information on …related party transactions.

In fact, from corporate governance perspectives, non-controlling shareholders are expected to check, directly or indirectly, transactions which involve conflict of interests in order to prevent or punish abusive self-dealings.[229] To this end, an effective disclosure of related-party transactions must concern the underlying conflicts of interest and include all information necessary to identify the transaction's business purpose from its implications for the controller's personal wealth. This is a precondition for identifying abusive type of corporate self-dealing from the fair one.

To this end, mandatory disclosure of conflicts of interest can be established both before and after related-party transactions are entered into; known as ex-ante disclosure and ex-post disclosure respectively. Although the latter can be used to complement the former, their purpose are different. As such, the purpose of ex ante disclosure is to enable a thorough scrutiny of self-dealing transactions,[230] while the purpose of ex-post disclosure is rather to inform non-controlling shareholders that a number of conflicted interest transactions were entered into, and of how the conflicts of interest were managed by the corporate controller.[231] In other words, insufficient disclosure of ex ante will undermine the procedural fairness of the transactions that helps to prevent in advance the occurrence of abusive self-dealing transaction while, relying just on *ex post* disclosure basically implies that self-dealing transactions by the corporate controller must be policed just by means of deterrence of harmful behavior often after the occurrence of the transaction.[232] This means, ex-post disclosure has little contribution in preventing the occurrence of self-dealing beforehand.

In both cases however, in order to fully identify the potential conflicted transaction, the precise nature and the extent of the conflicts should be disclosed in addition to how the conflicts involved

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[228] Alexandra Corlaciu and Adriana Tiron Tudor (2011), "Related Party Transactions – Overview," *Annales Universitatis Apulensis Series Oeconomica, vol.13 No.2*, p.4.

[229] See Kraakman *et al.*, Supra note 118, pp.101-130.

[230] See Luca Enriques, Supra note 2.

[231] See, Alessio M. Pacces, Supra note 24, p.529.

[232] See, Shavell, S. (1993), *The Optimal Structure of Law Enforcement*, in *Journal of Law and Economics, Vol. 36*, pp. 255-287, as cited in Alessio M. Pacces, Supra note 26, p.516.

are to be settled. In Ethiopia however, in the commercial code of the country, except the reporting requirement that auditors shall submit a special report to the general meeting relating to dealings approved by board of directors,[233] there is no clear disclosure requirements for self-dealing transactions. Here, the only requirement is that the approval of the related party transaction by board of directors shall be notified to the auditors and the latter shall submit this special report to the general meeting of the company and then, the general meeting has the power to take any measure it considers appropriate.[234] This implies, as the special report of auditors is after the transaction is approved by the board of directors, this kind of disclosure to general meeting is a kind of ex-post disclosure. But, there is no clarity on the manner and contents of this special report regarding self-dealing transactions.

On the other hand, the phrase "prior approval" in article 356(1) which provides "any dealings made directly or indirectly between a company and a director shall receive the prior approval of the board of directors..." implies that there shall be ex-ante disclosure of self-dealing transactions at least to the board of directors. Because, it is logically impossible for the board of directors to approve the transaction without having some information. However, still the problem is that there is no answer on what kind of information is necessary for board of directors that help to approve or not approve the self-dealing transactions.

3.2.1.3. Disclosure in Case of Self-Dealing Transactions under the Laws of Financial Sectors of Ethiopia

Firstly, with regards to disclosure requirements in banking sector of the country, art. 28(1) of Pro. No. 592/2008 provides that the NBE can force banks to disclose balance sheet certified by the auditors and any other information it require to investigate. Besides, art.28 (2) (a) of the same proclamation obliges banks to disclose the balance sheet and profit and loss that are certified by the auditors. In addition to disclosure, auditing is internationally recognized as one means of identifying self-dealing transactions. In Ethiopia however, though auditing requirement is generally provided in the commercial code and other laws of the country with all its limitations as discussed above, there is no auditing requirements with regard to self-dealing transactions

[233] Commercial Code 1960 (Ethiopia), Article 356(3).
[234] Ibid.

specifically.[235] Furthermore, Article 27 of Proclamation No.592/2008 talks about audit reports but this provision incidentally becomes relevant in that it impliedly recognizes the importance of the auditor in identifying and reporting the commission of financial fraud or dishonesty by a bank or its directors or employees. Particularly, article 27(4) (b) of this proclamation provides that the auditor should report that "…a criminal offence involving fraud or other dishonesty has been committed by the bank or any of its directors or employees." However, these general provisions may not address specifically the concerns of disclosure in self-dealing transaction.

On the other hand, there is no clear requirement of disclosure of self-dealing transactions in specific Directives concerned with Banking business including Directives No.SBB/53/2012.[236] Yet, some Directives can be mentioned as they incorporate provisions of disclosure requirement of self-dealing in Ethiopia, though not clearly mention self-dealing. First, let as see Fraud Monitoring Directives No. SBB/59/2014. As per article 4.1 of this Directives a bank shall have a well-defined fraud monitoring and control policies approved by the board, and procedures for fraud detection, mitigation and reporting. More particularly, with regard to disclosure requirement, art.4.5 of this directives provides that a bank shall maintain fraud register that shall at a minimum contain detailed records of the fraud including:

a. Name and complete address of the suspected fraudster
b. Description or type of fraud (embezzlement, cheating, forgery using fake instruments or others);
c. Cases of fraud
d. Position or profession of the suspected fraudster (director, employee, customer, or other party)
e. Amount of actual or estimated fraud
f. Date of occurrence of fraud
g. date of detection of fraud and reason for the delay (if any)
h. place and area of operation where the fraud has occurred

[235] For example, Articles 368-387 of the commercial code of Ethiopia talk about the different issues of auditors like appointment, terms of services, powers and duties of auditors. Besides, Directives No.SBB/53/2012 does not contain provisions dealing with auditing with regard to self-dealing transactions in banks in Ethiopia.

[236] Nevertheless, article 10 of Directives No.SBB/53/2012 provides "reporting" requirement. But, the requirements of disclosure and reporting are not strictly the same as the former is more necessary in providing information both before and after the transaction while, the latter require some information only after the transactions.

i. technique and/or technology used to commit the fraud
j. action taken or proposed to be taken to avoid such incidents
k. amount recovery if any
l. in case of attempted fraud, state reasons for failure of the fraud action and;
m. Any other relevant information.

Again, in addition to the reporting requirements of attempted or actual fraud to the NBE and boards, article 5 of the same directives importantly provides that: "The NBE, where necessary, may share the fraud information, in its general form and context, guaranteeing the anonymity and confidentiality, to other financial institutions including banks using appropriate means of communication."[237]

Thus, this Directive is particularly important in requiring banks to keep the register of extensive information of fraud in their institution and allowing the NBE to communicate this information to other financial institutions. Obviously, the concept of fraud in this Directive is inclusive of abusive self-dealing transaction. Hence, one can argue that the directive is providing ex-post disclosure requirement at least where there exist abusive self-dealing transaction. However, unless this information is made to be disclosed to the shareholders of a Bank and to third parties who will be potential shareholders, it cannot serve the general purpose of ex-post disclosure that aims to deter abusive self-dealing transactions.

Another relevant directive is the Bank Corporate Governance Directives No. SBB/62/2015. In its article 12.1 it prescribes that "Board and senior management of a bank shall be transparent to any shareholder, depositor and any other relevant stakeholders without breaching the law of the country and National Bank directives." In particular, banks are required to submit any related party loan/foreign currency transactions, bank's fixed assets and technology transactions of material nature, as defined by the board, to the National Bank within fifteen working days from the date of the transaction specifying the name, type of transaction and amount involved.[238] Besides, a bank has the duty to report the status of this transactions to the NBE, at least once in a month; through

[237] Fraud Monitoring Directives No. SBB/59/14, Article 5.
[238] Bank Corporate Governance Directives No. SBB/62/2015, Article 12.2.1.

attestation by the board that such transactions have been carried out at an arm's length in compliance with the regulatory requirements, the bank's own policies and procedures.[239]

However, this Directives also cannot meet the purpose of disclosure requirement of self-dealing transactions. For one thing, it does not require the company and the company's controllers to disclose every precise and essential informations of at least all substantial transactions that can help or harm the asset of the company if concluded by the company's controllers. Because, as it is evident from the clear language of the provisions the law limits the disclosure of self-dealing only to loan/foreign currency on one hand, and bank's fixed assets and technology transactions of material nature, on the other hand, leaving other many potential transactions that the potential self-dealers can abusively transact with the Banks. For another thing, the Directives also limit the duty of disclosure of this kind of transactions only to the NBE after the occurrence of the transactions. Moreover, it is not clear while it require just name, type and amount involved and thus, there is no clear requirement of all material facts about the transaction including description of the assets, nature and amount of consideration, explanation for the price and the degree of relationships that exist between the company and the corporate controller involved in the transaction. Nevertheless, to effectively prevent or deter the abusive self-dealing tarnsactions disclosure requirement should be made both prior to the occurrence of the transaction and after the transaction not only to the NBE, but also to all stakeholders including the shareholders, depositers and other interested third parties including those who will buy the shares of the company in the future.

Secondly, with respect to disclosure requirements in the insurance sector of the country, although article 33 of the Insurance Business Proclamation No. 746/2012 deals with disclosure requirements, it cover only disclosure of financial reports than clearly providing disclosure requirement in self-dealing transactions (i.e. both ex-ante and ex-post transactions), and it require more extensive disclosure only to the NBE than to all stakeholders. Generally, these and other provisions of the Insurance Business Proclamation No. 746/2012 are provided similarly as in banking business proclamation No.592/2008 and different Directives. As a result, the laws in both sectors does not contain detail rules with respect to disclosure of self-dealing transactions.

Lastly, in case of Micro-finance sector also, article 13 of Proclamation No.626/2009 provides about financial record and disclosure of information. This provision indicates the importance of

[239] Bank Corporate Governance Directives No. SBB/62/2015, Article 12.2.2.

preparing financial statements and disclosure of financial information to the National Bank of Ethiopia, depositors, creditors, investors or other stakeholders in the microfinance institutions. But note that, according to article 15(4) of the same proclamation, such information will not be disclosed to any person except in the following justified reasons. Accordingly, the financial information may be disclosed to any person, other than the National Bank of Ethiopia, only when the disclosure is: made for the purpose of fulfilling the requirements of this Proclamation, required to ensure the financial soundness of the institution, made to recipients who are legally authorized to obtain such information, made to the body to which the National Bank is accountable, ordered by a court or required for the purpose of meeting obligations which Ethiopia entered into under international agreement. However, note that the above provision does not deal with the requirement of disclosure in relation to self-dealing transactions.

In general, from the above discussions, it can be possible to conclude that though some disclosure and reporting requirements are relatively provided in the financial sectors than in the commercial code of the country, there is no extensive and efficient requirement of disclosure in the regulation of self-dealing transactions in the share company law of Ethiopia which can effectively and efficiently serve the purpose of both ex-ante and ex-post disclosure. In developed countries however, there are extensive disclosure requirements with effective and efficient enforcement, perhaps due to the existence of securities markets as in the presence of securities markets, companies designs their own systems to provide extensive and effective disclosures and set sanctions in case of non-enforcement depending on the circumstances. For example, they will make certain activities voidable in case of violations of disclosure requirements and thus, if the information about the transfer of shares which will entitle a shareholder to become an influential shareholders is missed that shares may not be enforceable at law.[240]

Lastly it is important to see the False Positives and False Negatives paradigm of Mandatory Disclosure. Accordingly, it is generally accepted that mandatory disclosure of conflicts of interests and of how they are handled by the corporate controller involves little risk of false positives.[241] Here, the problem of false positive could be occurred as too burdensome mandatory disclosure requirements may prevent the corporate controller from entering related-party transactions even in

[240] See Dieter Beinert, corporate Acquisitions and Mergers in Germany (2nd edn, Kluwer Law International 1997), p.33, as cited in Fekadu Petros Gebremeskel, Supra note 213, p.255.
[241] See Alessio M. Pacces, Supra note 26, p.516.

the absence of abusive self-dealing, especially in case of litigation friendly jurisdictions. On the other hand, it is normally the case that too lax disclosure requirements would lead to high frequency of false negatives.[242] Because, the problem of false negatives is obvious in case of absence of necessary disclosure as it hinder the shareholders and/or other delegated body to get necessary information that enable them to prevent or deter abusive self-dealing transactions by opportunistic corporate controllers.

Therefore, as extensive, but ineffective disclosure requirements would be of no use and it would compromise the enforcement of the entire discipline of self-dealing transactions,[243] it would be possible to conclude that under-enforcement of disclosure just leads to Type II errors whereby the abusive self-dealing transactions strengthened and abusive self-dealers left unpunished. In this regard, as we have seen above, the disclosure requirement of self-dealing transactions in Ethiopia is not extensively provided and as we will see it in the coming sections, it does not have necessary enforcement mechanisms even for those barely provided disclosure. As a result, this lax and under-enforcement of disclosure requirement obviously open the door for the occurrence of abusive self-dealing transactions and hence, leads to Type II errors/False Negatives problems where by wrong doers who unfairly expropriate the asset of the company can go free.

3.2.2. Standards

3.2.2.1. Standards in Corporate Self-Dealing Transactions in General and under the 1960 Commercial Code of Ethiopia

First of all, it would be possible to argue that what makes a certain self-dealing an abusive self-dealing is its departure from market conditions and thus, it could be possible to say that related-party transactions are fair as long as they are carried out at arm's length bargaining.[244] Here, the concept of "Arm's length transaction" is equivalent to a typical English expression to portray a transaction between perfect strangers.[245] Thus, to say the transaction between the corporate controller and the company they control is at the arm's length, it would be sufficient that they are entered into in terms which are comparable to those of an ordinary market transaction with a third party which unrelated to the interests of the corporate controller. However, the related-party

[242] Ibid.
[243] See Kraakman *et al.*, Supra note 118, pp. 103-105.
[244] See Alessio M. Pacces, supra note 26, p. 519
[245] Ibid.

transactions cannot meaningfully be compared with transactions concluded at arm's length in precisely those circumstances in which they have a legitimate business purpose.[246] Because, due to the corporate controllers managerial discretion to participate in transactions that involve conflict of interests, the efficiency of self-dealing depends on the (related) counterparty's being in the exclusive position to supply certain items, relationships, or contractual terms, which would not be available in a standardized market exchange.[247]

Thus, to cope with this problem the corporate governance provided with its own standards to ensure whether self-dealing is conducted at an arms' length bargaining. Accordingly, substantive standards of "fairness" to shareholders, defining the duty of loyalty owed by directors in self-dealing, perform a more modest role as it identify a standard of conduct whereby shareholders are not worse off because of the self-dealing transactions.[248] Generally, the standard of entire fairness which help to discipline self-dealing has two aspects: procedural fairness (standard of review) and substantive fairness (standard of conduct).[249] Let us see the two standards separately.

On the one hand, Standard of Review (Procedural Fairness) includes when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the board, and how the director and shareholder approvals were obtained.[250] In other words, standard of review states the test a court should apply when it reviews an actor's conduct to determine whether he complied with the standard of conduct.[251] Thus, it is the procedural standard which provides the mechanisms how the self-dealing transactions should be initiated and approved by the approving body. In this regard, it seems that art.356 of the commercial code of Ethiopia give the mandate of approval to the board of directors. However, there is no detail procedures that has to be followed by the board of directors while approving the transaction. Even, it is not clear whether or not the interested directors in the transaction can participate in the approval process. The issue of adequacy of allowing the board directors to approve self-dealing transactions will be addressed in more detail manner under

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[246] Ibid.

[247] See Alessio M. Pacces, Supra note 11, p. 194.

[248] Luca Enriques, G Hertig and H Kanda, "Related-Party Transactions" as cited in Kraakman *et al*, Supra note 118, p. 173.

[249] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983); Becker v. Knoll, 239 P.3d 830, 835 (Kan. 2010), as cited in Hecker (2013), Fiduciary Duties in Business Entities Revisited, *University of Kansas Law Review*, vol.61, p. 923.

[250] Ibid.

[251] See, Alessio M. Pacces, Supra note 26, p.521.

section 3.2.3.3 below by comparing it with the mandates of shareholders in monitoring self-dealing transactions.

On the other hand, Standard of Conduct (Substantive Fairness) relates to the substantive fairness of the transaction and thus, market value, earnings, future prospects, and any other relevant factors has to be reviewed objectively to establish fair price.[252] Hence, a standard of conduct concerns with how an actor should conduct a given activity or play a given role, in our case to ensure that whether the company controllers conduct the self-dealing transaction at the arms' length bargaining.[253] For long time, according to Melvin A. Eisenberg who was writing in 1993, the duty of care and the duty of loyalty have been the two major standards of conduct that traditionally incorporated under the corporate law.[254] To borrow from him, "the duty of care concerns the standards of conduct applicable to director or officer who takes action, or fails to act, in a matter that does not involve his own self-interest while, the duty of loyalty concerns the standards of conduct applicable to a director or officer in taking action, or failing to act, in a matter that does involve his own self-interest."[255]

In other words, the duty of care concerns in situations where the directors do not have a conflict of interest and it is the general duty to pay attention and to try to make good decisions, while the concept of the duty of loyalty is that the decision makers within the company should act in the interests of the company, and not in their own interests.[256] This implies, among the two components of standards of conduct, the duty of loyalty is relevant in the field of disciplining corporate self-dealing transactions as it is necessary to control conflicts of interest in the transactions.

In the Ethiopian share company law, as per article 364 (3) of the commercial code, boards of directors not only have a general duty to perform with due care in overseeing the managements of the company but also they have the responsibility to demonstrate that they are acting with due diligence and care as per article 364 (5) of the commercial code. Hence, in this case the share

[252] Ibid.
[253] See Alessio M. Pacces, supra note 26, p.521.
[254] See Melvin Aron Eisenberg (1993), The Divergence of Standards of Conduct and Standards of Review in Corporate Law, *Fordham Law Review, vol.62*, p.438, available at, http://ir.lawnet.fordham.edu/flr/vol62/iss3/1, retrieved on April 18, 2017.
[255] Ibid.
[256] Ibid.

company law is in compliance with OECD Principle V (A). However, there is no clear requirement of substantive duty of loyalty of directors against the company and the shareholders.[257] Generally, the code is failed to determine the roles of directors in nomination and election of board members; supervising and managing conflicts of interests with the company and corporate insiders, and monitoring company's disclosures as are clearly provided in OECD Principles VI, D.

The standards of substantive duty of loyalty is basically has to be checked by the courts of law after the transaction has taken place to review whether the approved self-dealing was really bargained at the arms' length standard. In the Ethiopian company law as per article 356(3) of the commercial code, it seems the review of approval of decision by the board of directors is given to the general meeting of the shareholders. On the other hand, the court can interfere and review the self-dealing transactions only if the plaintiff can prove the existence of fraud during approval of self-dealing transactions by general meeting. However, as the corporate controllers can expropriate the asset of the company without committing fraud,[258] the law has to provide detail procedural and substantive standards in the regulation of corporate self-dealing transactions.

3.2.2.2. Standards of Corporate Self-Dealing Transactions in the Laws of Financial Sectors of Ethiopia

To begin with the discussion of procedural standards in the banking sector, though it could be argued that the approval requirement under the commercial code is applicable, there is no clear approval requirement by the board of directors in the regulation of self-dealing transactions in the Ethiopian financial sectors except the prior approval requirement by the NBE, which is the regulator of Financial Institutions. However, approval requirement and its procedure specifically in the banking sector and in financial sectors in general is necessary to tackle the problem of self-dealing transactions as the sector needs special attentions for its peculiar nature. For instance, according to the guidelines prepared by the NBE in 2010, the board of directors is responsible for reviewing and approving a bank's credit risk strategy and policies. Particularly, it provides that each bank should develop a strategy that sets the objectives of its credit-granting activities and

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[257] One may argue that article 356(5) of the commercial code is indirectly providing the substantive duty of loyalty while it impose liability on the directors who engage in self-dealing transaction fraudulently. However, the substantive conduct of loyalty has to be clearly provided as one of the important duty of directors to effectively manage the conflict of interests between them and the company. Again for the same purpose, the duty of loyalty has to be provided between the controlling shareholders and the minority shareholders.

[258] See Djankov et al., Supra note 1, p.7.

adopts the necessary policies and procedures for conducting such activities.[259] Besides, it is stated that the board shall approve loans in line with Directives of National Bank of Ethiopia. However, this would be impossible for the board. Because, as we have seen above, the banking business and other financial sectors Directives do not provide clear approval and other procedural requirements including disclosure requirements.

On the other hand, the Banking Business Proclamation No.592/2008 and different Directives provides for the principle of arms' length bargaining in the related party transaction or self-dealing. Firstly, it can be mentioned here that even if it is not clearly provided, article 54 of Proclamation No.592/2008 has recognized the principle of arm's length in the banking sector in Ethiopia as reflected in the phrase that the transactions between the bank and insurance companies "…shall be undertaken on the same terms and conditions as provided to any other person." This is clearly the very concept of the arm's length. Secondly, the principle is recognized for example in article 6.4 of Directives No.SBB/53/2012 which provides that "Commercial banks shall not extend loans to related parties on preferential terms with respect to conditions, interest rates and repayment periods other than the terms and conditions normally applied to other borrowers." In the first place, according to this provision, the limitation and prohibition is confined to loan transactions of commercial banks with related parties and thus, it does not apply to other transactions, such as purchase or sale of goods, purchase or sale of assets, lease, receiving and rendering of services, with related parties. Secondly, the main issue is that even within the loan transaction, the limitation is restricted to "…preferential terms with respect to 'conditions, interest rates and repayment'…." The implication here again will be that the restriction will not include preferential terms with respect to other things not specifically mentioned above. However, there shall not be such restrictions and has to include other circumstances in which preferential dealings can be committed, if the purpose is to prevent abusive self-dealing transactions.

Besides, differently from the commercial code, the Banking Business Proclamation No. 592/2008 contains different provisions that enshrine about the standard of conduct (i.e. loyalty) with the aim to preserve the principle of arms' length bargaining in the self-dealing transactions, at least in the banking sector. For example, article 15 generally talks about prohibitions on the appointment of

[259] Bank Supervision Directorate: "Bank Risk Management Guidelines (Revised)," National Bank of Ethiopia (2010), p.2.

certain persons as officers, directors or employees of a bank. Accordingly, article 15(1) states that "No person who has been convicted of any offence involving a breach of trust or a fraud, whether in Ethiopia or elsewhere may be a director or an employee of a bank." Article 15(1) is concerned with discouraging the acts of breach of trust and fraud. Thus, a person who has been convicted of breach of trust and/or fraud cannot be appointed as a director or an employee of a bank. Conversely, abusive self-dealing transactions involve breach of trust or fraud when such act is committed by the insiders of the company such as a director or employee of the bank. This is because when the director does not act in accordance with his fiduciary duty or in due diligence and in the best interest of the company or when he commits fraudulent acts, there will be a breach of his duty or fraud. In this regard, it is worth mentioning that article 5.2 of Directives No.SBB/54/2012 provides for the integrity of the persons with significant influence. It generally states that such persons should be honest, reputable and diligent.[260]

Besides, article 15(3) provides "A director or chief executive officer of a financial institution may not, at the same time, serve as a director of a bank. Moreover, a business entity or a company in which such director or chief executive officer has ten percent or more equity interest may not serve as a director of a bank." The justification behind the prohibitions in article 15(3) could be because there will be conflict of interest between the bank and the concerned financial institution or because such director cannot serve best the interests of both the bank and the financial institution at the same time. Besides, if the director has greater than or equal to ten percent equity interest in another company, he cannot be a director in a bank, may be because the bank and the company will be related parties and conflict of interest will arise. With regards to Auditors, article 26(3) of the same proclamation provides that a person appointed as an auditor of a bank may not operate an account with, or be granted any type of loan, advance or facility from, that bank except in the normal course of business and at an arm's length basis. Here, it can be said that the law take great care to prevent the occurrence of abusive self-dealing by avoiding the existence of conflict of interest in case of banking business, rather than applying substantive standards like loyalty and arms' length principle.

Furthermore, though it does not directly prescribe the duty of loyalty between the company and company's controllers in case of self-dealing, article 2.5 of Fraud Monitoring Directives No.

[260] For more detail requirements on their integrity, please refer articles 5.2.1-5.2.3 of the same Directive.

SBB/59/14 indirectly contain the concept fiduciary duty of loyalty while it generally define what does fraud means. As per this Directives, fraud is an act or omission by shareholders, directors, employees, and customers committed with the intention of gaining dishonest or unlawful advantage for the part committing fraud or for other parties. Under its article 4.1 it has also provides that a bank shall have a well-defined fraud monitoring and control policies approved by the board, and procedures for fraud detection, mitigation and reporting. Besides, the Bank Corporate Governance Directives No. SBB/62/2015 generally in its article 4.1 provides that "No bank, director, or employee may carry out any transaction that is contrary to the bank's own policies, the regulatory requirements of the National Bank and other applicable laws".

To see the the regulation in insurance sector in this regard, it can be mentioned that the Insurance Business Proclamation No. 746/2012 has contain similar provisions with what are provided in the Banking business laws. For instance, as per article 15 (1) of Insurance Business Proclamation No. 746/2012, "…. a director, chief executive officer or senior executive officer of an insurer shall be a person with honesty, integrity, diligence and reputation to the satisfaction of the National Bank." However, the problem with this provision is that they do not provide the directors' duty of loyalty specifically while engaging in the self-dealing transactions. This problem is more prone as the commercial code of the country also do not provide for the clear fiduciary duty of loyalty between the companies controllers (i.e. Directors, Controlling Shareholders and influential managers) and the company as we have seen above.

Generally, for efficient policing of self-dealing transactions the two concepts of entire fairness discussed above (i.e. substantive fairness and procedural fairness) are necessary standards to prevent or deter abusive self-dealing and hence, protect the asset of the company from unlawful expropriation.[261] To this end, it is submitted that the requirement of procedural fairness is preferable to be met by virtue of independent assessment of the diversionary potential of the transaction while, the requirement of substantive fairness has to be checked instead by the court, on the basis of the evidence provided by the plaintiff and the defendant at trial.[262]

In theory, it is believed that, as the two requirements should be mutually exclusive and as the imperfections of the real world make this division merely suggestive, substantive fairness should

[261] See Luca Enriques, Supra note 2.
[262] Alessio M. Pacces, supra note 26, p.528.

be presumed in the presence of procedural fairness; and procedural fairness should be unnecessary once the substantive fairness has been ascertained.[263] In practice however, though International corporate practice shows that related-party transactions are hardly reviewed by courts where an independent assessment has been made and they do not involve diversion of assets or cash flow to either the corporate controller or one affiliate of his, courts do not abstain from reviewing related-party transactions when this independent assessment is lacking, or is unreliable.[264] Because, on the one hand, the requirement of independent assessment has a number of qualifications, which are very difficult to fulfill in practice and, on the other hand, whenever the assessment cannot be considered as actually independent, judges will have to take up the role of independent reviewers and review the transaction under an objective, substantive standard.[265] In this respect, though the Ethiopian share company law does not provides for the independent review of self-dealing transactions, it has provide that the court can interfere when the self-dealing transaction is the result of fraud.

In any case, the balance between Type I and Type II errors in the regulation of related-party transactions ultimately depends on this apparently easy, but practically very complicated, interaction of judicial abstention and judicial intervention in the review of corporate decision-making.[266] Thus, one may prefer the procedural standard in that it apparently minimizes the risk of false positives;[267] but one may still wish that a residual check on substantive fairness is performed by courts in order to cope with the problem of false negatives.[268] In this regard, under the share company law of Ethiopia, though there is no procedural fairness is provided to ensure arm's length transactions by the board of directors who is mandated to approve self-dealing transactions, it seems that the law intends to deny the court interventions in the decisions of the approving directors and the general meeting decisions. Because, as per article 356(4) of the commercial code the court is allowed to intervene and review the self-dealing transactions only if there is fraud in the decisions by the general meeting of the shareholders.

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[263] Ibid.
[264] See, Kraakman *et al.*, Supra note 118, pp. 105-109.
[265] See, Alessio M. Pacces, supra note 26, p.527.
[266] Ibid.
[267] Ibid, p.528.
[268] See, Kraakman *et al.*, Supra note 118, p.109.

3.2.3. Enforcement

It is true that, providing legal and regulatory framework is an important thing and necessary in the regulation of self-dealing transaction. But, it is not by any means sufficient. Because, the legal provisions against abusive related party transactions are meaningless without appropriate remedies, sanctions and implementation methods. In short, it implies not just "good" law, but "good" enforcement as well. Thus, due attention should also be given to the enforcement issue to achieve the objectives intended in the legal and regulatory frameworks.

Basically, there are two forms of enforcement Mechanisms: Private and public. As their names indicates, private enforcement is the system in which the members of the company (shareholders) by themselves or their agents initiate and enforce the law to protect their interests, while public enforcement is the system in which the government independently of the company or its shareholders both provide the legal frameworks and enforce the same. The private enforcement mechanisms in related party transactions include: market mechanism such as publicity, reputation and trust, extensive disclosure, approval procedures for transactions, and private litigation.[269] On the other hand, the public enforcement mechanisms consist of administrative, civil and criminal remedies and sanctions in case of violations of provisions on self-dealing transactions.[270]

In fact, recent researches have shown that the public and private enforcement are highly complementary in the field of self-dealing transactions especially in the countries where the securities markets are well developed.[271] Besides, it can be said that if the private enforcement mechanisms are found to be inadequate, the public enforcement mechanisms come/should come in to effect. However, this study is mainly focused on the private enforcement mechanisms as the variety of private enforcement strategies towards self-dealing is most interesting for assessing effectiveness and efficiency of regulation of self-dealing transactions.

Accordingly, in private enforcement, shareholders can tackle self-dealing transactions in one of the following ways. Firstly, after the occurrence of self-dealing transactions (i.e. *ex post)*, they can sue the company and its directors for having failed to disclose material information; they can sue

[269] Djankov et al., Supra note 1, pp.7-11.
[270] Ibid, p.2.
[271] JD Cox and RS Thomas (2009), "Mapping the American Shareholder Litigation Experience: A Survey of Empirical Studies of the Enforcement of the US Securities Law" *European Company and Financial Law Review, vol.6,* p.164, as cited in Alessio M. Pacces, Supra note 11, p.196

directors for breach of duty of loyalty; and they induce directors suspected of misbehaving to resign. Alternatively, non-controlling shareholders can intervene *ex ante* (before the self-dealing transactions) and stop potentially harmful self-dealing. To do that, as individual suit will be difficult in regulation of self-dealings as we are going to see it latter, collective action problems must also be overcome and investors or their agents need to have sufficient information and independence from the corporate controller. This is necessary ex-ante, to assess the prospective impact of related-party transactions on shareholder value and, in case of *ex post* enforcement, to avoid the occurrence of false negatives. However, as we are going to see below, establishing independent directors only for the purpose of controlling self-dealing transactions can counter the above problems as it can be both effective and efficient enforcers of a discipline of self-dealing without increasing the risk of false positives.

This being said generally about enforcement in the regulation of corporate self-dealing transactions, in the coming sections we will see specific issues including available sanctions and remedies with its deterrent effect, shareholders rights of litigation and the role of independent directors. These issues are important to assess the effectiveness and efficiency of enforcement of self-dealing transactions under Ethiopian share company law in general and in financial sectors in particular. Here however, note that the discussion in the coming sections will not be provided for the financial sectors separately as done in the previous sections. Because, as there is no extensive enforcement provisions in the laws of financial sectors and the enforcement provisions under the commercial code is applicable to the former in the majority of cases, it is indispensable to discuss them together.

3.2.3.1. Sanctions and Remedies

First of all, we have to note here that the remedies and sanctions in case of abusive self-dealing transactions are the two sides of a coin. Because, the only difference between the two is that while the remedy tries to discuss abusive self-dealing transactions from the context/side of the victim of such transactions, the sanctions considers such transactions from the context/side of the wrong doer. Thus, the discussion on the remedies and sanctions are not mutually exclusive and thus, both are equally important in preventing/deterring individuals or institutions from violating regulatory provisions and they should help to cure the problem which has been created by the violation of regulations. Generally, when there is/are violation(s) of a regulation on self-dealing transactions, in many countries, some sanctions will be taken against the violator and some remedies will be

available to the victim of such violation in general.[272] For example, the measures include: administrative, civil and criminal sanctions and remedies. Let us see them briefly in the following paragraphs.

First, Criminal sanctions in abusive related party transactions, obviously include penalty; both prison and fine, though the length of prison and the amount of fine will be different in different countries. For example, in France the penalty is a prison term of up to five years.[273] On the other hand, the criminal remedies generally here are in relation to the right of the victim to see that the violator of the regulation in self-dealing transaction is held liable criminally. Particularly, the remedy to the victim is to file a criminal charge against the violator in such case. For example, in Italy, public prosecutors can only start prosecutions for this crime of abusive self-dealings if the victim files a charge against the directors. But, note here that, until recently, the common view was that shareholders were not considered as victims of the crime. This was because there was the presumption that an abuse of corporate assets only harms directly the corporation so that shareholders' indirect damage was regarded as irrelevant for criminal law purposes. However, a recent Supreme Court case of Italy included shareholders among crime victims, so that now they may file a charge and also petition the criminal court for a conviction to damages suffered *qua* shareholders from the disloyalty i.e. their pro rata share of the total damage caused by the related party transaction to the corporation.[274] In Ethiopia however, the writer could not uncover the law and available cases that support shareholders to file a criminal charge against the corporate controllers who engage in abusive self-dealing transactions.

Second, as civil remedies, shareholders should have the right to request a court to: prohibit an abusive self-dealing transaction from occurring, that is, obtain an injunction, instruct directors to cease undertaking an abusive related party transaction, order the nullification of the abusive self-dealing transactions, ensure that profits derived from an abusive related party transaction are repaid

[272] However, mention should be made that the applicability of a sanction for breaching related party transactions provisions does not depend on whether the transaction caused any damage to the company. See generally, Laura Luputi, David and Baias Scpa: "Reporting Related Party Transactions and Conflicts of Interest" (Romania, 2004)17; Djankov et al., Supra note 1, p.7-11.

[273] See Peirre Henri Conac et al, Supra note 159. In France, the minority shareholder, acting derivatively in the name of the company, can initiate a criminal prosecution by filing a criminal complaint with the Dean of the Examining magistrates of the civil first degree court.

[274] Peirre Henri Conac et al, Supra note 159.

to the company and other appropriate remedies.[275] On the other hand, if one or more of these remedies are allowed for the plaintiff in the case, it is an imposition of civil sanctions on the losing party.

Thirdly, one or more of the following administrative sanctions can be taken: suspension or removal of individual directors or the whole board, issuing of warnings and, as a next step, policy directives with specific instructions, taking over of management, putting the institution under receivership, revoking the license and liquidation of the institution.[276] On the other hand, the administrative remedies are considered from the side of the victim of abusive related party transactions and thus, the remedies are the rights of the victim to request the concerned organ to take one or more of the above mentioned administrative sanctions.

When we come to the case of Ethiopia, though the company law do not specifically provide for the type of sanctions and remedies that will be applicable in case of violations of the rules and norms in the regulation of self-dealing transactions, it is possible to argue that the court can order civil, criminal and administrative remedies available in applicable laws. Nevertheless, of the three kind of sanctions mentioned above removal of Directors by the general meeting of the shareholders is recognized under Art.354 of the Commercial Code.[277] Particularly also, though there is no clear responsibility for the violations of disclosure requirements with regard to self-dealing transactions in the Ethiopian share company law, there are some consequences of non-enforcements of disclosure requirements. Firstly, with regards to disclosure to the public during the formation of the company, Art.309 (1) (c) of the commercial code provides that the founders are responsible for the accuracy of the statements in the prospects. As such, if there is deceiving information in the prospects or where no prospectus is provided during the establishment of the company, the person who is harmed due to this problem may be compensated and the wrong doers are liable by

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[275] OECD: "Guide on Fighting Abusive Related Party Transactions in Asia," Corporate Governance Series, September 2009, p.35, available @ www.oecd.org/daf/corporateaffairs/corporategovernanceprincip.pdf. In general, it can be said that the following remedies are available in abusive related party transactions, tunneling and/or self-dealing: liability suits, nullification of shareholder and board meeting resolutions (nullification suits), appointment of a special auditor and nullification of conflict of interest transactions. But, liability suit is the most common remedy here. Besides, the remedies in liability suits include class suits, derivative suits and individual suits.

[276] Stefan Staschen: "Regulatory Requirements for Microfinance: A Comparison of Legal Frameworks in 11 Countries Worldwide," Deutsche Gesellschaft für, 2003, p.41, available at, http://www.bu.edu/bucflp/files/2012/08/Regulatory-Requirements-for-Microfinance.pdf, retrieved on April 22, 2017.

[277] The provision provides that: "Notwithstanding any provision to the contrary, directors may be removed at any time by a general meeting: provided that a director who was removed without good cause may claim compensation."

the law of extra-contractual liability as per arts. 2035(1) and 2059 of the civil code of Ethiopia. Secondly, though there is no clear liability for breach of periodical disclosure requirements like annual report of profit and loss, Art.406 (2) of the commercial code provides that where the company deny the shareholders to disclose some documents which required to do so by the law, this fact should be brought to the attention of the Trade Minister. This implies the law tends to enforce such disclosure requirements through administrative sanctions.

On the other hand, though it is not sufficiently provided we can find different kind of sanctions in the law of banking sector of the country in which the NBE empowered to dismiss the directors and other officers of the Banks as per provided in the Proclamation No.592/2008 and the Directives. Accordingly, art.58 (6) (b) of Proc. No.592/2008 provides that "Any Director or an employee of the bank, with intent to deceive, makes any false or misleading statement or entry or omits any statement or entry that should be made in any book, account, report or statement of a bank, shall be punished with a fine from Birr 50, 000 to Birr 100, 000 and with a rigorous imprisonment from 10 to 15 years". Here, the phrase "with intent to deceive" shows that the law wants to punish intentional non-disclosure only.

The other relevant provision of Proclamation No.592/2008 with regard to enforcement may be article 17(2) (b) which deals about the suspension or removal of a director, a chief executive officer or a senior executive officer of a bank. Thus, as per this sub article, there will be a sufficient cause for the suspension or removal, by the National Bank of Ethiopia, of a director, a chief executive or a senior executive officer where there is "any action detrimental, in the opinion of the National Bank, to the stability or soundness of the financial sector, the economy or the general public interest carried out by a director, a chief executive officer or a senior executive officer of a bank." In this regard, it should be mentioned that abusive self-dealing transactions are generally detrimental to the company in general and the banks and its shareholders in particular. Here one can easily infer that the engagement of a director, a chief executive officer or a senior executive officer in an abusive self-dealing transaction in a bank will be at least against the interest of the bank and its minority shareholders and thus, followed by suspension or removal sanctions by the NBE.

Besides, the Bank Corporate Governance Directives No. SBB/62/2015 contains some administrative kind of sanctions which particularly addressed the enforcement of self-dealing

regulation against abusive self-dealers. Accordingly, as per Art.4.2 of the same Directives, a director who in any matter transacts or causes to be transacted or an influential shareholder for whom a transaction is concluded against the Bank's own policies, regulation of NBE, and other applicable laws, shall be:[278]

a. Prohibited from taking any new loans or renewing existing loans and concluding foreign currency related transactions with the bank in which he is an influential shareholder or director for three consecutive years effective from the date of identification of the violation;
b. Suspend or removed from his seat on the board for at least three consecutive years effective from the date of identification of the violation;
c. Prohibited from investing in new shares or buy existing shares in any financial institution for three consecutive years effective from the date of identification of the violation; and
d. Subjected to any other appropriate administrative action the National Bank deems necessary.

From the above provision, it is clear that the NBE is an organ that mandated to control the occurrence of abusive self-dealing transactions by punishing the wrong doers. However, this provision is not effective in the enforcement of self-dealing regulations for the following reasons. For one thing, there is no clear provisions on who is going to start the proceeding against those wrong doers to enforce the violations. For another thing, the sanctions against the wrong doers should not be limited on administrative remedies, rather the regulator should be able to order other liability against the wrong doers to compensate the victims. Moreover, though the NBE is the appropriate organ to control the activities of financial institutions including the Banks, the court of the law has to be allowed to enforce the law of self-dealing.

Generally, as we have seen above, the sanctions that are available to deter the abusive self-dealing in the Ethiopian law of self-dealing transactions both under the general share company law and the financial sectors of Ethiopia is not adequate to effectively enforce the law. Therefore, to effectively deter the occurrence of abusive self-dealing, the law on sanctions against the abusive self-dealers has to be improved to include the three basic punishments we have seen above. However, the law has to design sanctions and remedies against abusive self-dealings cautiously as the mere suspicion of abusive self-dealing may cause the sanctions in litigation-friendly

[278] Bank Corporate Governance Directives No. SBB/62/2015, Article 4.2.

environments for simply the company is doing badly. This situation over-deters self-dealing because lawsuits can be brought and successfully settled also in the absence of actual expropriation. Similarly, as giving non-controlling shareholders stronger powers to remove controllers independently of litigation will also expose to false positives by allowing the impositions of sanctions even in the absence of self-dealing,[279] the law has to carefully design the sanctions and remedies that has to be provided in the regulation of corporate self-dealing transactions.

3.2.3.2. Shareholders Litigation

It is necessary to discuss shareholder litigation separately because, for one thing it is one of the most important remedies of the shareholders to enforce the regulation of self-dealing transactions and, for another thing it has broad concepts to be addressed separately. The term 'shareholder litigation' comprises all civil actions brought by shareholders against managerial wrongdoings within companies in order to recover economic losses caused by them.[280] Many scholars have suggested that despite its limitations, shareholder litigation has an important role to play in effective corporate governance as giving shareholders effective remedies maintains investor confidence, by punishing improper corporate conduct.[281] We can see the shareholder litigation in the corporate governance in general and in controlling self-dealing transactions particularly, by dividing it in to two main categories: Direct and Derivative suit. Here, as we will see it below, it is important to note that the two types of suit can be brought individually or collectively according to the circumstances.

3.2.3.2.1. Shareholders Direct Actions/Suits

In the first place, shareholder(s) can directly sue the company controllers, though this right is very limited in the case of policing corporate self-dealing transactions as long as the dealing between the company and the company controllers cannot directly affect the shareholders. As such, direct

[279] See J Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment" in Alessio M. Pacces (ed), *The Law and Economics of Corporate Governance: Changing Perspectives* (London, Edward Elgar 2010), pp.213–258.

[280] See Paul Weitzel (2013), 'The End of Shareholder Litigation? Allowing Shareholders to Customize Enforcement through Arbitration Provisions in Charters and Bylaws', Brigham Young University Law Review, Issue 1, pp. 67–68; See also, Federico Pastre, How Shareholder Litigations Deter Directors and Officers: U.S. and Italy, a Comparative Analysis (GRIN Verlag, 2013), pp. 34.

[281] See William Kaplan and Bruce Elwood (2003), 'The Derivative Action: A Shareholder's "Bleak House"?' *University of British Columbia Law Review, vol.36,* p.451.

action refers to the claim of the shareholder(s) to sue the company, directors or third party on his/their own right and name because of a harm done to the shareholder(s) himself or themselves. In other words, shareholder direct actions are, in nature, 'personal claims' not brought on behalf of companies. Actually, in a derivative action, the company suffers financial losses because of wrongdoings, and the shareholder plaintiff suffers reflective losses in that case. But in a direct action, injuries are done to the shareholder plaintiff individually. One of the fundamental differences between those two actions may be that injuries in a direct action must be a special injury which does not equally affects all shareholders of the company.[282] As such, to identify the two close attention should be given to the issue whether a particular right of claim belongs more to the company or to the shareholders, and if it belongs more to the company, it should be a derivative action, otherwise, a direct action.[283]

In Ethiopia, article 367 is concerned with shareholders direct actions. Generally, article 367 of the commercial code talks about proceedings instituted by shareholders and third parties against director(s). In particular, this article provides that "Nothing in this section shall affect the rights of shareholders or third parties who have been injured by the fault or fraud of the directors." This provision is partly about the shareholders direct action against directors. The idea here is that even if the shareholders can derivatively sue the directors on the name and on behalf of the company, this will not prevent a shareholder(s) or a third party (parties) to institute an action on their own name and right if these shareholders or third parties faced a harm as a result of a fault or fraud committed by the concerned director(s). In general, it is possible for the company and the concerned shareholders to sue the directors for the damage each suffered by the faults, frauds or negligence of the directors.

3.2.3.2.2. Shareholders Derivative Suits

Shareholder derivative actions have been legally confirmed in many jurisdictions including the UK, the US, China, Japan, and Singapore.[284] Derivative actions enable certain shareholders to redress the company's losses on behalf of the company in the event that the company (the proper

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[282] See American Law Institute (ALI), Principle of Corporate Governance: Analysis and Recommendations (American Law Institute Publisher, Minnesota, 1994), Vol.2, pp.17–22.

[283] See Joseph Bishop, The Law of Corporate Officers and Directors: Indemnification and Insurance, (Clark Boardman Callaghan, 1981), pp. 3-10.

[284] In most of countries in continental Europe, derivative actions are legally allowed (e.g. Germany, Spain, Sweden, Austria, Slovenia, and Italy). But Dutch law does not permit derivative actions. See Paul Weitzel, Supra note 281.

plaintiff) is not able to bring a suit by itself.[285] For instance, when the company is substantially controlled by the wrongdoers, wrongdoings done to the company can be redressed by shareholders representing the company instead of the company per se, which could be regarded as a fundamental justification for the existence of derivative actions.[286]

In general, derivative action began and developed in both United States and English courts. In particular, the first United States derivative action was occurred "where a court permitted a shareholder . . . to sue and compel the directors to restore corporate assets taken in violation of their fiduciary duty in Taylor v. Miami Exporting Co., in 1831."[287] After this case, there developed famous English case between Foss and Harbottle in 1843, which is regarded as a leading English precedent in corporate law.[288] This latter case developed the rule or principle that "In any action in which a wrong is alleged to have been done to a company, the proper claimant is the company itself," and this principle is termed as the 'rule in Foss and Harbottle' and the several important exceptions that have been developed are often described as "exceptions to the rule in *Foss vs. Harbottle*".[289] Derivative action is one of such exceptions.[290]

As a result, because of its very nature,[291] the derivative action can only be applied in limited circumstances. For instance, a derivative action could only be brought for a certain range of causes of actions.[292] In this regard, article 356 of the commercial code of Ethiopia provides that the decisions of the general meeting can be challenged only in case of fraud. Thus, the plaintiff can brought derivative actions against the wrong doers in self-dealing transactions only if they can

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[285] See Xiaoning Li, A Comparative Study of Shareholders' Derivative Actions: England, the United States, Germany and China (Kluwer, 2007), p. 1.
[286] Ibid, pp.22-23.
[287] Amy M. Koopmann: "A Necessary Gatekeeper: The Fiduciary Duties of the Lead Plaintiff in Shareholder Derivative Litigation," *Journal of Corporation Law, Vol. 34, No.3,* P.4,
[288] Case opinions by Wigram VC: "Foss vs. Harbottle," (1843) 67 ER 189, (1843) 2 Hare 461, Wikipedia, the Free Encyclopedia, available at http://en.wikipedia.org/wiki/Foss_v_Harbottle, retrieved on March 21, 2017.
[289] Ibid.
[290] Ibid.
[291] As shown above in the case of *Foss vs. Harbottle*, Derivate suit is an exception to the general principle which provide that the company itself should bring its case as the company has its own legal personality.
[292] For example, in the US, the shareholder plaintiff should demonstrate that the company is in the "wrongdoers' control", and the derivative action would have been commenced by directors in good faith. And in the UK, a derivative action could be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company (section 260(3) of UK Companies Act 2006).

prove the existence of fraud in the decisions by the general meeting. From the procedural perspective on the other hand, in some jurisdictions like the UK and the US, the court's discretion on allowing a derivative suit is expressed in several procedure requirements specially designed for such litigation.[293] Here, it is worth mentioning that article 365 of the commercial code of Ethiopia also limit the rights of derivative action to shareholders who own 1/5th of the capital of the company.[294] But, to require this much shareholdings to suit misbehaving directors is too much burdensome on the rights of shareholders to challenge abusive self-dealing transactions by opportunistic corporate controllers.

Furthermore, the derivative nature of this litigation also explains the fact that, if the action is for damages, any award will be paid to the company, and not to the shareholders who brought the action on behalf of the company. For this reason, individual shareholder would not bring suit against corporate controllers, unless he expects the reward from such an action at least to offset the costs of litigation.[295] Nevertheless, none of the three remedies considered above is likely to bring him such a reward. Mainly because, abusive self-dealing do not harm outside shareholders directly, provided that resources are diverted from the company's assets, not from shareholders' pockets. Moreover, whatever is the damage determined by the corporate controller's misbehavior, individual shareholders would be only entitled to recover a part of it, depending on their stake in the company's value. This is also one factor to prohibit individual shareholder to sue the controllers on behalf of the company as it leads to the well-known free rider problem whereby other shareholders benefited from the litigation without contributing something.[296]

Indeed, the above problems of individual shareholder derivative suits would be solved if shareholders managed to coordinate in such a way that both costs and reward of litigation are divided pro-rata.[297] That is the type of shareholder litigation which we can call it "collective

[293] For example, in the UK, since 1 October 2007, the procedures in respect of all derivative claims have been set out in the Civil Procedure Rules 1998 (CPR) Parts 19.9 to 19.9F, Practice Direction 19C and UK Companies Act 2006 Part 11. Generally, the permission to continue the claim is a two-stage procedure (At the first stage, the shareholder plaintiff should present evidence to demonstrate the case is a prima facie one, otherwise, the claim will be dismissed by the court. And at the second stage, the court carries out a comparatively high degree of judicial discretion). See A. M. Gray (2012), 'The statutory derivative claim, an outmoded superfluousness', *Company Lawyer, Vol.33, No.10*, p. 297.

[294] Commercial Code 1960 (Ethiopia), Article 365(2) and 365(4).

[295] See Alessio M. Pacces, Supra note 26, p. 536.

[296] Ibid.

[297] See Alessio M. Pacces, Supra note 26, p. 537.

suit/class action", in which shareholders combine their interests and the costs of their litigation to effectively tackle the abusive self-dealing transactions. Though the laws in the Ethiopian financial sector do not contain clear provisions on the application of class action to self-dealing transaction claims, we can see some laws such as the 1995 Federal Democratic Republic of Ethiopia Constitution and the Ethiopian Civil Procedure Code which have a general application in class action suits.

As such, even if it is very general, article 37(2) of the Constitution of the Federal Democratic Republic of Ethiopia deals with the concept of class action. Accordingly, we may argue that the self-dealing transactions may be subject to class action in so far as the issue is justiciable matter. Besides, in civil procedure code of Ethiopia there are different provisions which provides for possibility of class actions in civil case matters.[298] One may also argue that article 367 of the commercial code of Ethiopia provides the concept of class actions but not clearly used the terms class action. The idea in class actions is that there is plurality of the shareholders in the action so that there is a representative litigation. Thus, we can argue that the above laws can be used as the class actions in self-dealing transaction claims in the Ethiopian financial sector too.[299]

Besides, even if it is not clearly provided in the laws dealing with the regulation of related party transactions in the Ethiopian financial sector, one can argue that the commercial code has some relevant provisions with respect to shareholders derivative and direct actions. Mention can be made that article 365, particularly 365(4) talks about shareholders derivative action. Article 365(4) of the Commercial Code of Ethiopia provides "where a resolution under sub-article (2) is adopted but the company fails to institute proceedings within three months, the shareholders who voted for the resolution may jointly institute proceedings." Generally, article 365(4) appears to have recognized the concept of derivative action of shareholders because the right of the shareholders to institute an action against the director(s) here is not a direct one. Rather, their right is based on and derived from the right of the company since the shareholders have the right to sue directors if the company itself does not sue the directors where a resolution to sue them was supported by the votes of shareholders representing at least one fifth of the capital within three months. Besides, it should be clear here that it is not all the shareholders of the company who can sue even derivatively

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[298] Civil Procedure Code 1965 (Ethiopia), Arts 35, 38, and 43.

[299] For details on the class actions in Ethiopia, See, Getachew Aberra (2009) "The Scope and Utility of Class Actions under Ethiopian Law: A Comparative Study," *Journal of Ethiopian Law*, *Vol.20*, pp. 21-61.

against the directors. It is only those shareholders who represent at least one fifth of the capital of the company and voted to proceed against the director(s).

When we come to see the practice in Ethiopia, even if it is difficult to get a case which clearly and purely deals with derivative action, there seems little practice in this area. For example, the case between Ato Gemechu Guta et al and Awash International Bank can be mentioned here as it deals with the concept of derivative action.[300] This case was instituted by five shareholders of the Awash International Bank for the dismissal of three board members. On the other hand, the board members have participated in the case as interpleaders claiming that they were appointed in the general meeting held in September 11, 2003 E.C. The court framed two issues in this case: 1. whether or not the plaintiffs had the right or interest to sue the Bank; 2. if they had the right to sue, whether or not their claim can be barred by period of limitation. Finally, the court held that the plaintiffs had the right to sue but that their claim is barred by period of limitation.

Recently also there is the case of class action decided by the Ethiopian Federal Supreme Court Cassation bench in 2008 E.C, between the Ethiopian Insurance Corporation and Ato Tsegab Gebru et al.[301] This case was appealed from the decision of North Western High court of Shire Indasellassie bench which decides against the present applicant (Ethiopian Insurance Corporation) to pay the alleged amount of compensations for the plaintiffs (the present respondents) and this was affirmed by the Supreme court of Tigray Regional State. The present cassation bench framed two issues including: 1. whether or not the plaintiffs can directly bring class actions in the same case against the applicant and, 2. Whether or not the exclusion provisions in the insurance contract between the insurer and the insured has to be respected. On the first issue which is relevant here, the court, by citing article 35 and 43 of the Civil Procedure Code of Ethiopia, decides that the plaintiffs cannot bring class action against the applicant.[302] In its reasoning, the court held that as the insurance contract is made between only the applicant and the first respondent, it is only the first respondent that can claim compensation for the damage that sustained by the property which is insured and other respondents can directly claim damage only from the owner of the insured

[300] Ato Gemechu Guta et al vs Awash International Bank, Lideta First Instance Court, File No. 188328.

[301] Ethiopian Insurance Corporation (Applicant) vs Ato Tsegab Gebru et al. (Respondents), Federal Supreme Court Cassation Bench, Vol.20, File No. 104544.

[302] Ibid.

property not from the insurer (the applicant).[303] As such, other respondents can claim rights against the applicant only if the first respondent request the applicant to join the suit against him as per article 43 of the civil procedure code. Here note that, though the case is not about shareholder litigation, it prescribe that any class action including collective action by shareholders has to be brought to the court not only when the rights in the case is emanated from the same facts or laws, rather, those claims have to be rightly established against the defendant.

In sum, as Coffee and Schwartz argues, though it plays an important role in deterring directors from breaching their duties and punishing breaches, the derivative action must provide a balance between giving an effective remedy to shareholders while at the same time allowing the directors of a company reasonable freedom from shareholder interference.[304]

3.2.3.3. Shareholders Vs Independent Directors in Monitoring Self-dealing Transactions

Of several ways to implement independent assessment of related-party transactions to prevent abusive self-dealing transactions, the most spontaneously used is prior approval of the transactions by the shareholders especially disinterested shareholders and it is considered as the purest case of arms-length endorsement of the transaction.[305] However, a conclusion that self-dealing transactions may enjoy full protection and enforced once they have been approved by a majority of shareholders is great mistake at least for the following reasons.[306] First, shareholders approving the transaction may not be independent from the corporate controller and a controlling shareholder may hold a sufficient majority to have any related-party transaction approved inappropriately. Second, shareholders may not be adequately informed to assess the potential advantage and disadvantage of such transaction. In both situations, shareholder approval would lead to false negatives as corporate controllers can easily deceive the approving shareholders and extract the asset of the company for their own benefits.

To avoid the above problems is possible only for one thing, by avoiding the influence that the corporate controllers can impose on the approving shareholders, and for another thing by providing the approving shareholders with the optimal amount of information which helps to assess the

[303] Ibid.

[304] John C. Coffee and Donald E. Schwartz (1981), 'The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform', *Columbia Law Review, vol. 81,* pp.302-309.

[305] See Djankov et al, Supra note 1, p.8.

[306] See Kraakman *et al,* Supra note 118, pp.109-111 and 121-123.

nature of self-dealing transactions.[307] In practice, however, the requirements for a truly independent shareholder approval are so burdensome and even if it is established, a corporate controller would choose to refrain from entering a related-party transaction unless there is a very big deal at stake. As a result, strict requirements of independence of approving shareholders would create the risk of false positives where the legitimate self-dealing transactions wrongly prohibited. On the other hand, there would be the risk that non-controlling shareholder will attempt to hold up abusive self-dealing despite the requirement of independence in order to foster their personal interests by using strategic voting. As this also may lead to a serious false negatives problem, it is difficult to avoid this dilemma of false positives and False Negatives to assure independent assessment of shareholders. Thus, it is believed normatively that "independent shareholder review of the corporate controller's conflicts of interest should be just limited to most significant related-party transactions (i.e. those that may result in either outrageous tunneling, or in terrific profit opportunities)."[308] In the Ethiopian share company law however, the approval by the board of directors and subsequent decisions by the general meeting is required for all kinds of self-dealing transactions without making distinctions.[309]

On the other hand, establishing independent directors at the board level can help to overcome the above problems of shareholders' approval and thus, ensure independent assessment of self-dealing transactions.[310] Indeed, independent directors are normally characterized as general monitors of the corporate controller's performance in managing the firm including the so called 'positional' conflict of interest.[311] Due to this fact, most recent developments in the literature cast a number of doubts on the ability of independent directors to do all these things together.[312]

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[307] Ibid.

[308] Luca Enriques, Supra note 2.

[309] However, the only exception is Article 356(3) which provides "The provisions of this Article shall not apply to normal agreements between the company and its clients." For instance, a director of certain company which provides transport services can travel by using the service of his company as any other client of the company by paying the required fee. Never the less, if he want to provide garage services for the cars of his company he have to go through the required procedures as this is not the normal agreements between the company and its client.

[310] See Kraakman *et al.* Supra note 116, pp.105-109.

[311] See, M. Becht, P. Bolton, and A. Röell (2002), Corporate Governance and Control, *ECGI Finance Working Paper No. 02/2002*, available at www.ssrn.com and www.ecgi.org, as published in G. Constantinides, M. Harris, and R. Stulz (eds.) [2003], HANDBOOK OF ECONOMICS AND FINANCE, North-Holland, pp.41-45.

[312] B.E. Hermalin, and M.S Weisbach (2003), Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature, *Federal Reserve Bank Ny – Economic Policy Review*, pp.7-26.

Therefore, to make Independent directors very useful for corporate governance, it is argued that their role has to be limited to the assessment of the self-dealing transactions.[313] A director may be independent in that he has neither direct nor indirect financial involvement in the transaction and with the corporate controller or with any third party that affiliated with the person involved in the transaction. This is just a necessary condition for an independent scrutiny of related-party transactions, but is not sufficient.[314] Because, independency of the director will be still under the influence of the corporate controller as the appointments and tenure in the office of the former is basically at the discretion of the latter.[315] Hence, if we want independent directors to carefully scrutinize the self-dealing transactions, they must be both accountable to shareholders and appointed independently of the corporate controller. Because, formally independent directors, who are appointed by the board itself or, even worse, by a controlling shareholder, cannot be entirely relied upon.[316] Thus, independent directors should be appointed by somebody else, equally interested in maximization of shareholder value but with exactly the opposite interest in diversion of the same value. To this effect, non-controlling shareholders seem to be the only possible option.[317]

When we see the share company law of Ethiopia it has no clear provisions which require for the establishment of independent directors and rather, it contains controversial provisions in terms of board member compositions. Thus, there may be three types of board structures under the share company law. First, article 348 (3&4) of the commercial code clearly stipulated that the general manager is an employee of the company and may not be members of the boards. Therefore, in this case all board members become none-executive. Second, article 363(2) of the commercial code provides that the articles of association should determine whether all boards or one/more board member are managers of the company. In this provision, there will be two possible board structures. On one hand, in case where the articles of association assign all board members to be managers of the company, all the boards' composition become executive directors. On the other hand, in case where the articles of association only specifies one/more directors as manager of company, the rest of board members are non-executives and the composition becomes executive

[313] See Alessio M. Pacces, Supra note 26, p.543.
[314] Ibid.
[315] Ibid.
[316] Ibid, p.544.
[317] Ibid.

and non- executive boards. Thus, the two provisions seem to contradict and needs to be in harmony to avoid confusion. Especially, it will be more difficult for boards to make objective and independent judgement when all boards are assigned by articles of association as managers of the company pursuant to article 363(2) of the commercial code.

On the other hand, to deliver independent and objective judgements and avoid conflicts of interests, the existence of non-executive and independent board members in the company is crucial. In this case, the separation of chairman of boards and manager pursuant to 348(1&4) of the commercial code is one step. However, as we have seen above there is the possibility that all board members are executive directors as per article 363(2) of the commercial code. In such case, there will be apparent conflicts of interests when executive boards review their own transactions with the company pursuant to article 356 of the commercial code. The problem is more prone as there is no requirement of disclosure by board members in Ethiopian share company law. Particularly, this is contrary to Principle III.C of OECD which provides members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation. There is no such requirement in place in Ethiopia for self-dealing transactions.

Contrary to the provisions of commercial code we have seen above, the banking directives in the financial sector seems to establish independent board of directors while it provides the board of a bank shall comprise of non-influential shareholders whose number shall not be less than:[318]

a. One-third ($1/3^{rd}$) of the total board members elected separately by such shareholders provided that such shareholders hold at least 30% and above of the subscribed capital of the bank; or
b. one-fourth ($1/4^{th}$) of the total board members elected separately by such shareholders provided that such shareholders hold less than 30% of the subscribed capital of the bank no matter what the proportion of their shareholding in the bank is.

Besides, as per art.6 of the same Directives (i.e. Bank Corporate Governance Directives No. SBB/62/2015), the General Meeting of Shareholders shall strive in a good faith to ensure that only competent and reliable persons who can enrich good corporate governance and add value to the

[318] Bank Corporate Governance Directives No. SBB/62/2015, Article 5.3.

bank are elected or appointed as a board. To this effect, the mandate of electing the nomination Committee who is responsible for nominating candidates for the board memberships is also given for the same meeting. And, nomination committee has to be elected from and by shareholders, composed of not less than five shareholders, that is directly accountable to shareholders, independent from the board of the bank, and shall not have a seat on the board of the bank.[319] Besides, it is prescribed that at least two of nomination Committee members, no matter what the committee's size is, shall be non-influential shareholders.[320] Therefore, from the above provisions it is evident that there is steps in the share company law of Ethiopia to establish independent board members at least in the banking sector.

Particularly also with regards to self-dealing transactions, article 10.4.14 of the same Directives also provides that directors has the responsibility of preventing conflict of interest in the bank by putting in place sound policies and implementing them, where conflict of interests refers to a circumstances where one of a person's activities or interests are advanced at the expense of the bank. It seems that, the law is leaving discretions for the board to provide its own procedural and substantive standards and policies to regulate self-dealing.

However, this is inefficient as the board of the directors may design the policies which may enhance its own benefits at the expense of the company and non-controlling shareholders while providing the policy of self-dealing transactions by itself. Similarly, other than approval requirements by directors, key functions of boards to review related parties transactions are not stated in the commercial code of the country.[321] On the other hand, Principle III.A.2 of OECD provides minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders, acting either directly or indirectly, and should have effective means of redress. In this specific principle, Ethiopian share company law does not contain sufficient provisions which regulate self-dealing by controlling shareholders, and obtaining redress in cases of abuse remains a challenge. Hence, the legislature has to prepare a policy on how to include the roles of the directors in controlling abusive self-dealing transactions in addition to providing detail definitions and standards that helps to effectively and efficiently regulate self-dealing transactions.

[319] Bank Corporate Governance Directives No. SBB/62/2015, Art. 6.1.4.
[320] Bank Corporate Governance Directives No. SBB/62/2015, Art. 6.2.
[321] Commercial Code 1960 (Ethiopia), Art. 356.

Summing up, as argued by many scholars regulation of self-dealing would become efficient if it is exclusively relying on independent directors that would be elected by non-controlling shareholders and by limiting their mandate to monitoring self-dealing and similar conflicts of interest which may result in expropriation.[322] The present writer is also in support of this view as it is really important to efficiently manage the problem of corporate self-dealing transaction by keeping the balance between the discretionary power of the management and the constraint on their decision by shareholders to engage in transaction which involves conflict of interests. Moreover, Independent directors serve the corporate governance especially in Dispersed companies (i.e. NCS) in a way that if managers feel that they are being closely monitored by the independents, they will make decisions that are better aligned with those of the shareholders, and if they try to deviate, the independent directors will use their voting rights to prevent it.

3.3. Anti-Self-Dealing Index and the Regulation of Self-Dealing Transactions in the Share Company Law of Ethiopia

Depending on the above discussions and following Djankov et al. (2008), I measure the Ethiopian regulation of self-dealing with the anti-self-dealing index as follows. Although the index is limited to measure the strength of minority shareholder protection against self-dealing by controlling shareholders, it is relevant so far as controlling shareholders can engage in self-dealing transactions in Ethiopia. The index is designed to capture transactions where the controller of a company makes choices to benefit himself at the expense of other investors and measures the difficulty for minority shareholders to prevent abusive self-dealing or to recover damages if a controlling shareholder decides to enrich himself while following the law. In other words, it measures the hurdles that the controlling shareholder must clear in order to get away with such a transaction. Thus, it shows that the more hurdles, the higher score a country receives on the anti-self-dealing index and, the higher the score in turn shows, the more regulations a country has adopted to protect against self-dealing.

For this purpose, the description of variables used in the study by Djankov et al is reproduced in Table 1 below and Table 2 and 3 tries to present the score for Ethiopia as per the Index identified by the same researchers. For this matter, the same hypothetical case (i.e. a hypothetical self-dealing transaction between two firms controlled by the same person, which can in principle be used to improperly enrich this person) that used to develop the above Index is presumed as it exist in

[322] See Alessio M. Pacces, Supra note 11, p.179.

Ethiopia. In other words, the case of Mr. James who is representing the controlling shareholder in two transacting companies (i.e., Buyer and Seller) and also an interested director in the transactions between these two companies is considered as the hypothetical case that possibly exist in Ethiopia too.

Table 1. Description of the Variables collected for the 72 countries in Djankov et al. study which are collected from the questionnaire sent to Lex-Mundi firms.[323]

No.	Variables	Description
1	Approval by disinterested shareholders	Equals 1 if the transaction must be approved by disinterested shareholders, and zero otherwise.
2	Disclosures by buyer	Index of disclosures that are required before the transaction may be approved. Ranges from 0 to 1. One-third point if each of the following items must be disclosed by Buyer to the public or its shareholders before the transaction is approved: (1) Mr. James owns 60% of Buyer; (2) Mr. James owns 90% of Seller; and either (3) all material facts or the following three items: (a) description of the assets; (b) nature and amount of consideration; and (c) explanation for the price.
3	Disclosures by controlling shareholder	Index of disclosures that Mr. James must make before the transaction may be approved. Ranges from 0 to 1. Equals 0 if no disclosure is required. Equals 1/2 if only the existence of a conflict of interest must be disclosed, without details. Equals 1 if all material facts must be disclosed.
4	Independent review	Equals 1 if a positive review required before the transaction may be approved (e.g., by a financial expert or independent auditor), and zero otherwise.

[323] Djankov et al, Supra note 1, pp.45-46.

5	Each of the elements in the index of disclosure in periodic filings	Index of disclosures required in periodic disclosures (e.g., annual reports). Ranges from 0 to 1. One fifth-point for each of the following items: (1) Mr. James owns 60% of stake in Buyer; (2) Mr. James owns 90% of Seller; (3) shares held beneficially by Mr. James (i.e., shares held and/or managed via a nominee account, trust, brokerage firm or bank); (4) shares held indirectly by Mr. James (e.g., via a subsidiary company or holding); and either (5) all material facts about the transaction or the following three items: (a) description of the assets; (b) nature and amount of consideration; and (c) explanation for the price.
6	Standing to sue	Equals 1 if a 10% shareholder may sue derivatively Mr. James or the approving bodies or both for damages that the firm suffered as a result of the transaction, and zero otherwise.
7	Rescission	Index of the ease in rescinding the transaction. Ranges from 0 to 1. Equals 0 when rescission is unavailable or only available in case of bad faith, or when the transaction is unreasonable or causes disproportionate damage. Equals ½ when rescission is available when the transaction is oppressive or prejudicial. Equals 1 when rescission is available when the transaction is unfair or entails a conflict of interest.
8	Ease of holding controlling shareholder liable	Index of the ease in holding Mr. James liable for civil damages. Ranges from 0 to 1. Equals 0 when the interested director is either not liable or liable in case of bad faith, intent, or gross negligence. Equals 1/2 when the interested director is liable if he either influenced the approval or was negligent. Equals 1 if the interested director is liable if the transaction is unfair, oppressive, or prejudicial.
9	Ease of holding the approving body liable	Index of the ease in holding members of the approving body liable for civil damages. Ranges from 0 to 1. Equals 0 when members of the approving body are either not liable or liable in case of intent, bad faith, or gross negligence. Equals 1/2 when members of the approving body

		are liable if they acted negligently. Equals 1 if members of the approving body are liable if the transaction is unfair, oppressive, or prejudicial.
10	Access to evidence	Index of access to evidence. Ranges from 0 to 1. One quarter point for each of the following four rights: (1) a shareholder owning at least 10% of the shares can request that the Court appoint an inspector to investigate Buyer's affairs; (2) the plaintiff can request any documents relevant to the case from the defendant (without specifying which ones); (3) the plaintiff may examine the defendant without the Court approving the questions in advance; and (4) the plaintiff may examine non-parties without the court approving the questions in advance. One-eight point for each of the following two rights: (1) the plaintiff may examine the defendant but questions require prior court approval; and (2) the plaintiff may examine directly the non-parties but questions require prior court approval.

Table 2. Ex-ante control of self-dealing for Ethiopia

	1	2	3	4	5	6
Country	Approval by disinterested Shareholders	Disclosure by Buyer	Disclosure by Controlling Shareholders (James)	Independent review	Ex-ante disclosure (Average (2)-(4))	Ex-ante private control of self-dealing (Average (1) and (5))
Ethiopia	0	0	0	0	0	0

As it is presented in table 2 above, the score for ex-ante private control of self-dealing is zero for Ethiopia since the score for all components determined to establish the index of ex-ante private

control of self-dealing is zero and thus, the average of these components also equals zero. Let us see the components one by one.

- Firstly, as explained above in section 3.2.2 of this chapter the Ethiopian share company law adopt that the self-dealing transactions has to be approved by board of directors and latter ratified by the general meeting of the shareholders, not by disinterested shareholders (article 356(1-3) of the commercial code). The financial sectors law of the country also do not clearly provide the body who is mandated to approve such transactions except the banking Directives which impose general duties on the board of directors to oversee transactions involving conflict of interests. As a result, the score for this component is obviously zero as it is described in table 1 above.
- Second, the score for ex ante disclosure by buyer company is also zero as Ethiopian share company law does not require any disclosure before the transaction is approved. Similarly, the controlling shareholder (Mr. James) is not required of any disclosure under the share company law of Ethiopia and its score is also zero depending on the description under table 1.
- Third, the score for independent review is also zero as Ethiopian share company law does not require any independent review of the transactions before it materializes.
- Lastly, the index of ex-ante disclosure which is the average of the last three indices is zero similarly with Austria and Ecuador as reported in Djankov et al, while in contrast it is 1 in Chile and the UK where ex-ante disclosure is fully required.

As such, the score of Ethiopia for the index of ex-ante private control which is the average of the first component (approval by disinterested shareholders) and the average of the last three components equals zero as presented in the above table.

Table 3. Ex-post private control of self-dealing and anti-self-dealing index for Ethiopia

	1	2	3	4	5	6	7	8	9

Country	Disclosure in periodic filings	Standing to sue	Rescission	Ease of holding Controlling Shareholder liable	Ease of holding approving body liable	Access to Evidence	Ease of proving Wrongdoing (Average (2)-(6))	Ex-post private control of self-dealing (Average (1) and (7))	Anti-self-dealing index
Ethiopia	0	0	0	0	0	0.75	0.15	0.08	0.04

Table 3 shows both the index of ex-post private control of self-dealing and the overall anti-self-dealing index. Accordingly, the score for the ex-post private control for Ethiopia equals 0.08 as it is calculated by the average of disclosure in periodic filings (0 index) and the index of proving wrong doing (0.15). As explained in the table, Ethiopia score 0.75 for component of access to evidence. The score for access to evidence is 0.75 because among the elements to establish this component, Ethiopia will acquire: 1) ¼ (one-fourth) as it is possible for a shareholder who represent 10% of the capital of the company to request the Trade Minister (though not court) to appoint an inspector as per article 381 of the commercial code; 2) ¼ (one-fourth) as it is possible for the plaintiff to examine the defendant without the court approving the questions in advance as per article 261(2) and article 263 of the civil procedure code of Ethiopia; 3) again ¼ (one-fourth) as it is possible for the plaintiff to examine the non-parties without the court approving the questions in advance as per the same provisions of the same code. On the other hand, Ethiopia score nothing on the following components:

- The score for disclosure in periodic filing is zero because all five items/elements which are described to establish this component is not provided in the Ethiopian law. And, the annual report required to be submitted by the company in Ethiopia required to contain only the balance sheet and loss and profit account of the company and never require the elements of index for disclosure in periodic filings as described in table 1 above.
- The score for standing to sue is zero because though the index require 10% threshold for the shareholders to sue the controlling shareholder or the approving body for the damage sustained by the company as a result of abusive self-dealings it is only possible in Ethiopia for shareholders who possess 20% of the shares of the company as per article 365(2 and 4) and 356(5) of the commercial code of Ethiopia.

- ❖ The score for rescission is zero because in Ethiopia it is possible to rescinding the transaction only if there is bad faith (fraud) in case of approval by the general meeting of the shareholders and rescinding is not possible if the transaction is not approved by the meeting, but the approving directors may be liable for fraud he committed (article 356(4 and 5)).
- ❖ The score for ease of holding controlling shareholder liable is also zero in Ethiopia as firstly there is no clear liability on the controlling shareholder (interested director) if he was not participated in the approving process and if he participated in the approving process also he may be liable only in case of fraud (intent of deceiving) as per article 356(5) of the commercial code of Ethiopia.
- ❖ The score for ease of holding the approving body liable is also zero in Ethiopia as it is possible to make the approving directors liable only in case of fraud (bad faith) as explained above. And, in case fraud is committed in the decisions by the general meeting, liability is not provided and the only option is setting aside such the transactions as per article 356(4) of the commercial code.

Generally therefore, Ethiopia score 0.08 for the index of ex-post private control of self-dealing which compresses the index of disclosure requirements after the transaction is approved (0) and the ease of proving wrongdoing (0.15). This shows that disclosures requirements are absent and it is difficult for plaintiffs to prove wrongdoing in court in Ethiopia as it score 0 and 0.15 respectively. And finally, when we see table two and three together, the score of Anti-self-dealing Index for Ethiopia which is the average of ex-ante private control of self-dealing and ex-post private control of self-dealing equals 0.04 which is less than the least score of Ecuador (i.e. 0.08) as identified in the work of Djankov et al. Thus, the Ethiopian regulation of self-dealing transactions needs improvement as it is extremely low when compared to the average score of the index which is 0.66 in common law countries and 0.35 in civil law ones.[324]

[324] See Djankov et al., Supra note 1, p.18.

CHAPTER FOUR

CONCLUSIONS AND RECOMMENDATIONS

4.1. Conclusions

The subject of Self-dealing transactions attracted the attention of many scholars and, countries have started to regulate it effectively and more specifically only recently after different empirical researches have shown the negative relationship between abusive self-dealing transactions on one hand, and the development of companies and capital markets on the other hand. As such, modern theory of corporate governance focuses on the ability of corporate insiders to divert corporate wealth to themselves without sharing it with other shareholders. Empirically also, such diversion of resources from firms to their controllers has been investigated by many scholars including Djankov et al who has conducted empirical research in 2008 to explore the question what should be the role of the law in addressing the problems of corporate self-dealing transactions by collecting data from 72 countries. And, their research shows effective regulation of self-dealing transactions extremely contributes for the development of capital markets by safeguarding proper investor's rights protection.

Consequently, many countries have moved from totally prohibiting self-dealing transactions to providing with the general guidelines and standards in order to identify what types of self-dealing transactions has to be prohibited and/or permitted. Currently, we can infer the existence of a strong belief that shareholder and investor protection mechanisms such as timely and transparent disclosure, approval processes, effective procedural and substantive standards and enforceable regulations are indispensable in the regulation of self-dealing transactions than prohibiting self-dealing transactions all together.

In the Ethiopian share company law also, the fact that only some types of self-dealing transactions, such as loans to executives, are prohibited signifies that the regulators have impliedly recognized that the other types of self-dealing transactions are legitimate and that they can enhance efficiency of the company. However, note should be made on the importance to clearly define the concepts of self-dealing transactions to easily identify the potential self-dealers in the company which in turn help to identify legitimate self-dealing from abusive self-dealing transactions. Though little attempt is made under the commercial code to regulate self-dealing transactions by the directors, it left to include and regulate self-dealing transactions by the managers, controlling shareholders

and other third parties that has conflicts of interest in the transactions with company and possess the ability to unfairly divert the asset of the company. In fact, extensive definition of related parties are listed in the financial sectors especially in the banking business directives. However, those directives do not attempt to define what self-dealing transactions/related party transactions are. In addition to providing the clear concepts of self-dealing transactions it is necessary to provide effective legislative frameworks in order to tackle abusive self-dealing transactions and maintain the legitimate one.

To this end, firstly effective disclosure requirement is the most important mechanism to regulate self-dealing transactions. As such, the body which entitled to monitor self-dealing transaction has to be informed with all necessary information including the extent of relationships of the parties engaging in the transactions and all material information in relation to the transactions. However, disclosure requirement of self-dealing transaction is provided neither in the commercial code nor in other laws in Ethiopian financial sector (except for the reporting requirement in some Directives).

Secondly, providing effective procedural and substantive standards is necessary to ensure effective and efficient regulation of self-dealing transactions. Because, it is possible to identify what kind of transactions are legitimate and what kind of them are abusive only if the law provides mandatory standards that has to be respected by the corporate controllers who want to engage in the transactions with the company that they control. Note here also that, though it is discussed separately because of its importance, disclosure requirement is also one of the procedural standards that has to be respected in the regulation of self-dealing transactions. Accordingly, a certain transaction in which the corporate controllers engaged in through the proper procedural and substantive standards are considered as legitimate whereas, abusive self-dealing transactions if it violates those standards. This implies that not all self-dealing transactions are prohibited. For example, if the self-dealing transaction was concluded at arm's length, such a transaction will not be prohibited. Because, insofar as such a transaction does not affect the interests of the shareholders, company or creditors, there is no reason to prohibit it. On the other hand, it is when a transaction in which a conflict of interest involved gives an economic benefit only to the company controllers without sharing it with other shareholders and the company by infringing the law that such a transaction has to be prohibited. Therefore, it will be important to distinguish between normal (at arm's length) self-dealing transaction and an abusive self-dealing transaction.

Of the procedural standards in the regulation of self-dealing transactions, approval or ratification of the transaction is worth mentioning. As such, the law has to provide proper procedure for the approval mechanism of the transaction including who will be the approving body and on what basis the transactions has to be approved. With this regard, though there is no uniform practice all over the world, countries have been preferred the disinterested shareholders as most appropriate approving body to endorse the standard of arms' length in corporate self-dealing transactions. Now times however, the establishment of independent directors who are mandated only to approve and monitor the regulation of self-dealing is getting acceptance in many jurisdictions including the US and UK corporate governance. In Ethiopia however, the review, approval or ratification requirements in relation to self-dealing transactions are not clearly provided.

Thirdly, as defining the concepts, providing disclosure requirements and standards by itself cannot serve any purpose without really enforcing them, enforcement mechanisms is vital to prevent abusive self-dealing transactions beforehand and/or deter it after the transaction. Thus, if the transaction is found to be abusive, it should be noticed that different sanctions will be followed. Generally the sanctions are civil, administrative and criminal penalties which also serve as remedies for the victims of abusive self-dealing transactions. However, except few of these sanctions and remedies, no clear sanctions and remedies are provided both in the share company law of the country in general and the law of financial sectors in particular, in case where the rules on self-dealing transactions are violated.

Generally, it could be argued that the regulation of corporate self-dealing transactions in the share company law of Ethiopia in general and in the financial sector in particular, is given little attention. Though it is good to come up with some laws dealing with the regulation of self-dealing transactions such as the Bank Corporate Governance Directives No. SBB/62/2015 which attempt to prohibit abusive self-dealing transactions, much more is expected from the legislature to come up with clear and detailed provisions to effectively and efficiently control abusive self-dealing transactions. Specifically, issues such as the need for broad and clear definitions of self-dealing transactions, disclosure requirement, providing procedural and substantive standards, approval requirement by independent directors and effective use of shareholders' derivative or class action suits through the introduction of legal incentives such as in the burden of proof, power of discovery and attribution of legal fees has to be addressed in the share company law of Ethiopia. Otherwise, all these legal and regulatory loopholes of the share company law provisions will have potential

impacts on investors’ investment decisions. And, this in turn not only creates loss of investors’ confidence in the Ethiopian capital markets but also results in market inefficiency, raises the cost of capitals and inefficient use of scarce resources in the country.

4.2. Recommendations

Based on the discussions and findings made in this thesis, the following recommendations can be provided from four major points to be addressed in the regulation of self-dealing transactions including: Definition of the concept of self-dealing transactions, Disclosure, Standards and Enforcements.

4.2.1. Providing Clear Definition of Self-dealing Transactions

- The share company law of Ethiopia shall deal clearly and sufficiently with the definition of self-dealing transactions that can help to identify all potential self-dealers. More particularly, the definition for self-dealing transactions under article 356 of the commercial code shall cover all the company controllers including Directors, managers, controlling shareholders and other affiliated third parties that can be influenced by these controllers while entering in to self-dealing transactions.
- The regulation of self-dealing transactions in financial sector of the country focus on loan transactions between the related parties. However, other forms of self-dealing transactions including the sale or purchase of goods, assets, rendering of services, leases, sharing of assets and management and transfer of any asset and benefits in the company shall be included in the regulation of self-dealing transactions.

4.2.2. Disclosure Requirement

- Though there are some disclosure requirements concerning the share companies in general, they have to be improved in light of OECD principles and other best practices to ensure good corporate governance in all respects.
- As it stands now, disclosure is not sufficiently required in the regulation of self-dealing transactions in the Ethiopian share company law and the financial sector of the country. However, as it is one of important mechanisms to prevent abusive self-dealing transactions beforehand (i.e. by requiring ex-ante disclosure) and to deter the same by requiring ex-post disclosure, the legislature has to provide the standards of disclosure including what information has to be disclosed (i.e. Mandatory vs optional disclosure), what time to

disclose (Ex-ante/before transaction vs Ex-post/after transaction), to whom and by whom it has to be disclosed and others.

4.2.3. Standards

- Elements of procedural fairness (i.e. standard of review) regarding self-dealing transactions are completely absent (except naming the board of directors as the approving body and the general meeting of shareholders to ratify the transaction) in the share company law of Ethiopia. Thus, as it is really important to determine whether or not the corporate controllers and/or other potential self-dealers has complied with another standard (the standard of conduct), the legislature has to incorporate this standard. For instance, there shall be clear approval procedures for self-dealing transactions to be followed by boards of directors.
- Similarly, the elements of substantive fairness (i.e. standard of conduct) which relates to the substantive fairness of the transaction that has to be reviewed objectively to establish fair price of the transaction and relevant in the regulation of self-dealing transaction is also absent (except some provisions in the financial sectors). However, the legislature has to incorporate this standard as it is really important to check the substantive conduct (i.e. loyalty) of the potential self-dealers.
- Above all, the Ethiopian commercial code has to clearly provide at least the minimum requirement of arm's length principle in the regulation of self-dealing transactions as it is attempted in the regulation of financial sectors.

4.2.4. Enforcement

First of all, as enforcement is very crucial in order to achieve the objectives of the legal and regulatory framework, due attention should be given by the legislature to the same on how to effectively and efficiently enforce the rules and regulation of self-dealing transactions. As such, to effectively and efficiently enforce the regulation of self-dealing transactions:

- The legislature has to provide for the establishment of truly independent board of directors for the purpose of monitoring corporate self-dealing transactions in the relevant share company law of the country. In order to make use of independent directors the law has to strive to avoid different factors that hinder the independency of the said directors including the problems with their appointment and remuneration.

- As it is very important to corroborate the enforcement by the independent directors the legislature has to improve the shareholders litigation provisions. Thus, the requirement of 1/5th of the capital to sue the wrongdoing directors where the company failed to do the same has to be lifted out and substituted by other requirement which can really control the opportunism of the suing shareholders (like, requiring to prove the existence of some convincing facts and depositing certain amount of guarantee against the failure to establish the claim). Besides, the law has to provide certain incentives for the proper derivative and class suits including enhancing access to necessary information and attributing legal fees.
- Besides, the share company law of Ethiopia has to provide for clear sanctions and remedies for the violations of self-dealing transactions regulation.
- In addition to providing robust legislative and regulatory framework, due attention shall also be given to awareness creation program to the business community and training to the concerned organs such as regulatory organs and judges in fighting abusive self-dealing transactions.
- Generally, the relevant part of the commercial code of Ethiopia, and different proclamations and directives which tries to regulate self-dealing transactions in the financial sectors in a way relatively better than the commercial code has to be revisited in order to incorporate the above mentioned recommendations and other best practices of corporate governance with regards to the regulation of self-dealing transactions.

Reference Materials

A. Laws

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