Evaluating the Concept of Minority in Corporate Group Context: A Specific Look at Minority Shareholders of the Subsidiary Company

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Abstract

Despite the practical presence of corporate groups in Ethiopia for some decades now, the notion of minority in corporate group context has not been explicated in domestic literature. In this article, an attempt is made to evaluate the concept of minority with particular emphasis on minority shareholders of the subsidiary company. Section I of this article will provide some background on the Ethiopian law on minority shareholders in general. Section II will explain who the minority shareholder in the subsidiary is. Section III discusses the rationale for the protection of minority shareholders of subsidiary company. Finally, minority shareholder (of the subsidiary) rights are discussed from a comparative perspective.

Introduction

One can find in vain a universal definition for "groups of companies". Under Dutch law, group of companies are defined on economic basis, whereas in Germany the term is defined on a legal basis.[1] Control of one company (a parent company) over basic managerial decisions of other company/ companies (subsidiaries/sub-subsidiaries) is the bond that generally gives rise to group relationships. Thus, a group of companies may mean an entity/economic

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[1] Under Article 24b of Book II of the Duch Civil Code, corporate group is defined to mean "an economic unit in which legal persons and partnerships are united in one organization." For German law, such legal persons should however come together under a unified management for a group to be deemed formed; see Andenas, M. & Wooldridge, F., *European Comparative Company Law*, Cambridge University Press, Cambridge, 2009, p.479, [hereinafter Andenas & Wooldridge].

unit comprising of a parent (holding) company and one or more subsidiaries and sub-subsidiaries that are operating under the holding company's umbrella.[2]

No matter how a group relationship is established, the companies in the group structure retain their separate juridical personality and enjoy the resultant limited liability. Thus, legally speaking, the parent company – of even a wholly owned subsidiary – neither incurs additional liabilities (either vis-à-vis minority shareholders or creditors of the subsidiary) nor enjoys additional benefits emanating merely from the group relationship.[3] This is true despite the parent company's right of control which vests it with the power to freely dictate the internal management affairs of its subsidiaries. The parent company's managerial decisions over its subsidiaries or sub-subsidiaries are meant to promote the so called "corporate group policies" that are of course reflections of the financial interests of the parent. As such decisions are not legally required to be in line with the financial interests of the subsidiary, big enterprises (nationals or multi-nationals) prefer business operation via the group form to branches or divisions.[4] Of course, such economic integration absent legal integration in the sense that members to the corporate group retain their legal identity is considered as the most important incentive for an enterprise (holding company) to conduct business by establishing new subsidiaries or by holding shares in already established companies (subsidiaries).

[2] Such relationship of control could emanate from the majority of voting rights of one company in the general meetings of the other or through contracts which entitle the holding company to express rights of control.

[3] This is true in jurisdictions that rely on traditional company law rules for the regulation of groups. But, in jurisdictions with separate separate regiems for corporate groups, e.g. Germany, there are express rights of control as well as duties on the holding company; see Andenas & Wooldridge, *supra* note 1, pp.455 and 480.

[4] Muscat, A., *The Liability of the Holding Company for the Debts of its Subsidiaries*, Dartmouth, Brookfield, 1996, p.4 [Hereinafter Muscat].

When one examines the other side of the coin, the parent company's management policies are likely to erode the financial interests of one or more of its subsidiaries in the guise of corporate group policy. Most often, the parent company is majority shareholder in the subsidiary company. However, the harm sustained by the subsidiary is not felt by such parent regardless of its shareholding in the subsidiary because this majority shareholder (the parent) generally benefits from the overall group strategy. The ultimate risk would therefore rest on the minorities and creditors of the subsidiary; hence the need for statutory protection of the subsidiary's minorities.

Company law generally looks after the subsidiary's minorities against the parent's abusive and unfair conducts as a corollary to the recognition of the group structure. In recognizing the group structure, the 1960 Commercial Code of Ethiopia contains few provisions that are said to exclusively protect minority shareholders of the subsidiary company. For example, the law has imposed an obligation on the parent company to prepare the accounts of its subsidiaries and to submit to the annual general meeting at the same time and in the same manner as its own accounts.[5] The law also states the possibility of extending expert investigations that are being held in a company to cover the affairs of its parent or subsidiary company under certain circumstances.[6]

By allocating special obligations on the parent company, these special rules of the Commercial Code were initially said to exclusively deal with the group arrangement with a view to protecting minority shareholders and creditors of subsidiary companies. However, the Code's recognition of the "group" form is

[5] Article 451 (1), Commercial Code of Ethiopia, 1960, *Negarit Gazeta*, Proclamation No. 166/ 1960, 19th Year, No.3 [hereinafter Commercial Code]. Though it suffers from lots of exceptions, the rules in the Commercial Code entitle minority shareholders of a subsidiary company to get access to information regarding company management and structure. Note also that there are detailed rules of considerable importance to the group context.

[6] *Ibid*, Article 384.

not coupled with a stipulation on threshold or mode of control that a company should (potentially or factually) exercise over other company/companies for such entities to have control relationships. It is not clear who the subjects of the obligations and rights enshrined under the provisions discussed above really are.[7] Unless there are clearly defined rules on group formation, courts would find it hard to impose the special obligations of the parent company that the Code has clearly provided. The absence of a stipulation on threshold is thus likely to have serious repercussions on the interests of minority shareholders of subsidiary companies, but, even so, it is not uncommon to see in Ethiopia enterprises that are branded as "groups of companies" or "holding companies".

Right now, minority shareholders of the subsidiary company can only be protected by the rules that govern the majority[8]-minority relationship in the individual company. Though minority shareholders of the subsidiary company may seek protection via the provisions meant to protect minority shareholders in the individual company, the problems of the former [9] are quite different from

[7] Banking Business Proclamation No. 592/2008 uses the term "influential shareholder" to refer to a shareholder who directly or indirectly holds 2 % or more of the total subscribed capital of the company. Accordingly, among private persons a person holding 2 percent of the shares is likely to be an influential shareholder.This threshold seems too small to make a shareholder influential; but anyway the law restricts anyone –other than the government – from holding on his own or jointly with specified persons more than five percent of the shares of a bank (See Articles 1(11) *cum* 11(1), Banking Business Proclamation, 2008, *Federal Negarit Gazeta*, Proclamation No.592, Year 14, No.57). This threshold does not however serve as an authority in defining parent company for the purpose of the Commercial Code because it specifically addresses financial institutions who have recently been largely excluded from the scope of coverage of the company law provisions of the Commercial Code.

[8] Here, we can generally take the majority to mean the controlling company (parent company in the economic sense) in its shareholder capacity.

[9] This can simply be demonstrated by the risks minority shareholders of the subsidiary encounter by the conducts of the parent which is usually a majority shareholder in the subsidiary; see Section 2 *infra* for more.

the latter; hence a doubt on the effectiveness of the Commercial Code provisions in tackling the unique problems of the subsidiary's minorities.

However, this article is not interested in examining the effectiveness of the Commercial Code in protecting minority shareholders of the subsidiary company. Given the unique features of minority-majority relations in the individual company on the one hand and those in the group context on the other, the article rather attempts to surface how the concept of minority shareholder should be understood for the purpose of effective minority shareholder protection. The article tries to show who, among the diversified classes of shareholders of the subsidiary company, should qualify as minority shareholder for protection via minority rights. Before forwarding ideas on how minority rights should be understood in the context of group relationships, the article explains the possible justifications for special protections to minority shareholders in groups.

For comparative perspectives, the laws of England and Germany are consulted for they represent relatively rich jurisprudence in the regulation of groups.[10] Also, reference to laws of the United States and the Netherlands as well as the OECD Principles of Corporate Governance is made wherever appropriate.

In the Commercial Code, there are no rules that impose special obligations on groups having the private limited company (PLC) form. The relevant

[10] England follows the traditional approach to corporate group regulation. Under this approach, which is the dominant approach worldwide, regulation focuses on the individual entity (i.e. it treats the parent or subsidiary as a separate unit). This approach is also embraced by the Commercial Code of Ethiopia. Germany, on the other hand, has come up with special rules governing groups, and few countries are following this trend. Germany was the first European country to regulate the relationship between parent company and its subsidiaries through a special legal regime. Later, Portugal and Italy followed. Brazil is the only non-European country to adopt a special and systematic group regulation law. Under this approach, the group is treated as a single economic unit. See Andenas & Wooldridge, *supra* note 1, p.451.

provisions of the Code deal exclusively with groups of companies formed by the share company (SC). As a result, the article is confined to analyzing these provisions.

1. Some Background on the Status and Regulation of Corporate Groups in Ethiopia

As noted earlier, business enterprises having the suffixes "holding" or "group" in their names can be found in Ethiopia. A parent-subsidiary relationship may also be formed *de facto*, even though an economic unit formed thereof does not tag the words "holdings" and "groups" in its name. In economic terms, the economic unit is created when a centralized management is achieved between the companies. There are no legalization procedures for their formation. Procedures of registration, for example, are not required to create the group. Such business reality might not be felt by either the controlling company or the controlled company.

In legal systems that stipulate some criteria for the formation of such economic unit, the group is deemed to be created upon the fulfillment of the same. Yet, Ethiopian law does not (1) provide for the factors that give rise to parent-subsidiary relationships and (2) and lay down clearly stipulated legal standards that govern parent-subsidiary relationship. It is not thus clear if a corporate group is (legally speaking) formed where a company holds majority shares of another and effectively exercises management control or where a company has the power to steer the decisions of board of directors of another company and is able to pursue its interests at the expense of the other company. This uncertainty may discourage corporate group formation. In an interview with *Forbes Global Magazine*, a general manager[11] of a big Ethiopian company

[11] *Interview with: Mr. Melaku Beza*, General Manager, National Mining Corporation (March 15th, 1999, World INvestment News). An electronic edition of the special country report on Ethiopia published in Forbes Global Magazine(July 26th, 1999).

explains how the absence of a law on corporate groups affects their invetsment decision:

> "We are establishing a corporate office...It will be a holding company when the law comes. So far, there is no law for holding companies. We are 100% autonomous, and we are a private limited company. We have got corporate guidelines which we respect, otherwise all our financial decisions, human resources decisions, are limitless independent, and 100% autonomous. We report to our corporate office, in budgeting, and accounting, so that they will be aware of what we are doing. Otherwise, all the companies are 100% autonomous. We are now establishing this holding company".

Far beyond the disincentive such uncertainty brings about on investors, we are still very much in the dark about how the interest of minority shareholders of the subsidiary (share)[12] company is protected. A 2008 study on corporate governance in Ethiopia reveals ownership concentration and pyramid structures were among the core problems of corporate governance in the country.[13] The Commercial Code does not impose a restriction on one's magnitude of shareholding in a company; hence the need for addressing the concern of minority shareholders in group context or otherwise.

Be that as it may, it is clear that group relationships having share companies as their ingredients are allowed in the Commercial Code. Article 451 imposes legal obligations on a holding company for accounting purposes. In addition, some other provisions[14] of the Code imply corporate groups are recognized

[12] Should the majority shareholders' prefer PLC instead of SC, further problems regarding appropriate protection of minority shareholders would loom. This is because: (1) minority shareholders are exposed to oppression due to the unregulated and autonomous management structure of PLC and (2) a minority shareholder that opts for exit may not effectively exercise his right since the shares issued by the company are not freely transferable.

[13] Minga, N., *Rethinking Corporate Governance in Ethiopia* (September 2008), available at: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1264697&download=yes>.

[14] See, e.g., Articles 370, 379, 384, Commercial Code.

under Ethiopian law. Like Ethiopia, France and England[15] provide for some special obligations of a parent company, without however a separate group law in place. But unlike English and French law, Ethiopian law is silent on the factors or standards that trigger the formation of the relationship; hence, application of the obligations is intangible. This is a major source of legal uncertainty that should worry minority shareholders and creditors as well.

In general, group relationships materialize where a controlling company exploits the finance and assets of a subsidiary while the former is without additional legal duties or liabilities. Absent specific rules on the protection of minority shareholders in corporate group context, the ordinary rules on the protection of minority shareholders in an individual company apply for parent-subsidiary relationships.

Incidentally, corporate group laws of most continental legal systems including that of France ignore the doctrine of fiduciary duties of directors and replace it by a detailed regulation of directors' dealings with the company.[16] Uniquely, the Commercial Code of Ethiopia clearly recognizes the fiduciary duty of directors. In particular, Article 364 stipulates that directors owe their company a duty of care expected of an agent. Therefore, as an agent a director is duty bound not to place himself in a position where there is a likely for conflict between his own personal interest and his duties to the company.[17] The Code also regulates dealings between the company and an interested director in a detailed manner.[18] Accordingly, certain transactions are prohibited and are

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[15] See Pennington, R., *Pennington's Company Law*, 6th ed., Butterworths, London, 1990, p.749 [hereinafter, Pennington].

[16] See generally Tunc, A.,"The Fiduciary Duties of a Dominant Shareholder", *in* Schmitthoff, C. & Wooldridge, F., *Group of Companies*, Sweet & Maxwell Ltd, London, 1991, pp.1-119.

[17] See also Andenas & Wooldridge, p.273, for a discussion on English law.

[18] Article 356, Commercial Code.

automatically declared void. Certain transactions, on the other hand, are subject to the shareholders authorization procedure.

2. Who is a Minority Shareholder in the Subsidiary?

2.1. General Overview

Any attempt to define "minority shareholder" by specific reference to the subsidiary company would generally be informed by two separate trends in company laws worldwide. As seen already, groups of companies may be regulated either by traditional (general) company law or a special law for group structures. In Ethiopian and United Kingdom, group structures are subject to traditional company law provisions. Minority shareholders of the subsidiary company are not thus subject to special provisions. As a result, any meaning ascribed to minority shareholder of the individual company does not change due to the mere fact that such company has become a subsidiary of some other company.[19] The meaning of minority shareholder of the subsidiary company is simply sought from company law provisions pertaining to individual company.[20] The German *Aktiengesetz*,[21] on the other hand, has come up with special regulatory provisions for groups of companies – *konzern*. The rules regulating the individual company and its minority shareholders are not applicable once a group is legally formed.[22] Under German law, which recognizes special rights and obligations of the holding and subsidiary companies, minority shareholder of an affiliate/subsidiary is defined differently from minority in the individual company.[23] The nature of the applicable regime

[19] The same holds true as regards minority shareholders of the holding company.

[20] This is also the approach taken in this article.

[21] This is the German Stock Corporation Law [hereinafter cited as AktG].

[22] The general company law applies with regard to *de facto* groups, however.

[23] See section 2.4 *infra*.

for the regulation of group structures may therefore determine our conception of "minority shareholder".

Below, the concept of minority is discussed. In so doing, the writer does not rely more on statutory provisions than literature, as neither Ethiopian nor English laws define minority shareholder. Yet, a separate discussion on minority shareholder of an affiliate company as enshrined in the German AktG would, the author hopes, complement the dearth.

2.2. Minority Shareholder Defined: Shareholding or Control?

There is a tendency to qualify a shareholder as minority based on voting shares. For example, in the United Kingdom, even after the enactment of the 1985 Company Act, the amount of shares one holds was emphasized in distinguishing a majority shareholder from minority counterparts. Accordingly, a shareholder that holds more than fifty percent of the equity share capital of the company alone or acting in concert was considered a majority shareholder.[24] But, as seen below, such a shareholder may in fact be a minority shareholder unless he exercises control of the company.

Timmerman[25] defines a minority shareholder: "a shareholder who irrespective of his shareholding in the company is unable to exercise a significant control within the company". *Control* demarcates the boundary between the majority and the minority.[26] The magnitude of shareholding or capital investment of a shareholder has no place unless this is accompanied by control of the management of the company. Absent control within his company, a

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[24] Muscat, *supra* note 4, p.86.

[25] Timmerman, L. & Doorman, A., 'Rights of Minority Shareholders in the Netherlands' (2001), p.5; available at <http://www.ejcl.org/64/art64-12.pdf> [Hereinafter Timmerman & Doorman].

[26] However, as we will see it in detail below, it is hard to imagine a precise dichotomy between shareholders as majority and minority without investigating conflict of interest situations.

shareholder who holds fifty percent or more of the voting rights of the company may thus still qualify as a minority shareholder. This is especially the case where another shareholder can appoint or dismiss the majority of directors. On the other hand, a shareholder who is without majority shareholding may be deemed a majority shareholder as far as he is capable of exercising control of the company.

Since control may take various forms, any definition of minority shareholder must take into account the possible modes of control involved; hence, our definition of minority is likely to vary with companies involved. As Timmerman suggests in connection with the concept of minority under Dutch company law,[27]in a company where capital and control are dismembered as a result of control mechanisms such as priority shares, the issuance of preference shares, pyramid structures or the statutory two-tier regime, identification of the minority within a certain company must take into account any possible ways of influence (control) that a shareholder may have[28] because the underlying forces determining its direction and momentum are more important than the size of one's investment – a bit like being a heavyweight on account of muscle rather than fat.

In the absence of any one of the aforementioned structures of control, i.e. when capital and control are parallel, "minority shareholders are those who contribute a significantly smaller percentage of the company's capital than the largest shareholder"[29]

The very notion of parent-subsidiary relationship implies a company should have control of another company for it to be regarded as a parent. Logically, the parent company is thus automatically excluded from the class of minorities. But, this does not necessarily imply that all shareholders (with the exclusion of the

[27] Timmerman & Doorman, *supra* note 25, p.4.

[28] *Ibid*.

[29] *Id*, p.5.

parent company) are minority shareholders of the subsidiary. Even among the remaining shareholders, those who are connected with the parent company (e.g. a shareholder director of the subsidiary that is appointed by the parent) are generally excluded from the group of the minority.

2.3. Ethiopian conception of minority shareholder

Under Ethiopian company law, there is no clear definition of minority shareholder. Nevertheless, some provisions of the Commercial Code give us clue on the Ethiopian conception of minority. As one's decision-making power in general meetings is the common factor in determining the existence of holding-subsidiary relationships,[30] our discussion here revolves around rules pertaining to decision making power in the ordinary general meeting of shareholders. Alternatively, however, one's power – which may, for example, be contractual – to appoint or remove board members of the company may also bring about effective control even in the absence of decision power in the

[30] This is hardly surprising as shareholders' ordinary general meeting is vested with the power to oversee other management bodies including directors and auditors. It appoints and removes directors and auditors. It also sets their remuneration (see Article 419 (2), Commercial Code). The annual general meeting discusses the company's situation and prospects on the basis of documents and reports submitted by directors and auditors and it may approve, amend and approve or refuse to approve same. If the annual accounts are approved and profits are available for distribution, the meeting decides on the distribution based on directors' proposal (Article 419(1)). Ordinary general meeting can also decide on issues involving the issuance of non-convertible debentures. Generally, matters other than those reserved to extraordinary general meeting are within the scope of power of the general meeting. See also Gizachew Sileshi, *Law of Traders and Business Organizations Teaching Module*, Bahir Dar University, School of Law, Bahir Dar, 2008, p.156 [hereinafter, Gizachew].

general meeting; hence, additional emphasis on rules related to shareholder power in appointment and removal of board members.[31]

The Commercial Code confers control power on the shareholder contributing a bigger share of the capital of the company. As a rule, shareholders' ordinary general meeting passes binding resolutions by simple majority of the voting shares represented;[32] and every share carries at least one vote.[33] The total number of votes a share carries is in proportion to the amount of capital it represents;[34] hence, the principle that control should correspond with capital.[35] Under normal circumstances, a shareholder contributing significant portion of the capital of the company therefore possesses the majority of the voting rights (the majority vote) in the meeting. Simply put, such shareholder becomes a majority shareholder. So, minority shareholders are shareholders that possess less than fifty percent of the voting rights in the general meeting.[36]

Conversely, there are exceptions to the principle of "every share carries at least one vote" and hence to the rule "votes are proportional to amount of capital investment". As a result, a shareholder may control the company without holding a significant percentage of the capital.[37]

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[31] One's power to appoint or remove the majority of the board members can also be used as an alternative yardstick for control and hence parent-subsidiary relationships; see, e.g. United Kingdom Company Act, 2006, s 1159.

[32] Articles 421(1)-(3), Commercial Code.

[33] *Ibid*, Articles 345(3) and 407(2).

[34] *Id*, Article 407 (1).

[35] This principle has also been embraced by a report of a group of leading European company law experts. See *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, Brussels, 2002, p.3; available at: <http://ec.europa.eu/internal_market/company/docs/takeoverbids/2002-01-hlg-report_en.pdf>.[herein after Report of High Level Group EU].

[36] This is simply because they contribute less than fifty percent of the capital of the company.

[37] Timmerman & Doorman, *supra* note 25, p.4.

An exception to the rule that every share shall carry at least one vote concerns preference shares. The voting right of preference shares, where they exist, may be restricted to matters which concern extraordinary general meetings.[38] Thus, their right to vote in annual general ordinary meeting may be withheld. Nevertheless, such restriction can only be made against preference shares giving priority over profits and/or distribution of capital upon dissolution of the company.[39] Therefore, voting rights of preference shares for preferred right of subscription in the event of future issues may not be restricted either in ordinary or extraordinary general meetings.

Pyramid structures represent another instance of control by shareholders who do not however provide a larger percentage of the company's capital.[40] As noted by the Report of the High Level Group of Company Law Experts of the EU[41]"pyramid structures in a different way achieve a similar disproportionality between [capital investment] and control rights to that which is, for example, achieved by multiple voting rights".[42] This happens when a person[43] exercises

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[38] Article 336(3)-(4), Commercial Code; see also Gizachew, p.120.

[39] *Ibid*, Article 336(3).

[40] Timmerman & Doorman, *supra* note 25, p.4.

[41] Report of High Level Group EU, *supra* note 35, p.38.

[42]Nevertheless, in every holding company in the pyramid one may strictly maintain proportionality between capital and control. This may be achieved for instance by strict adherence to company law principles that guarantee proportionality between capital and control. Yet, by "just holding the minimum percentage required to retain control and by having minority shareholders in each holding company to finance the exercise of control by the ultimate owner," economic disproportionality may still be attained. See Report of High Level Group EU, pp.38-39.

[43] In some European jurisdictions, the controlling person need not necessarily be a company. For example, in the Netherlands the Heineken family that owns a holding company which in its turn controls another holding company (see note 46 and the accompanying texts) qualifies as person. By the same token, 'person' must as well refer to all business entities and persons such as sole propritors, parnerships and of course companies.

ultimate control over a company through a chain of holding companies each owning a controlling interest in the next one. There are non-controlling (minority shareholders) in every holding company in the chain. Under such an arrangement, the person who sits at the peak of the chain controls[44] the company at the bottom of the hierarchy through a relatively small capital investment therein,[45] that is to say the person at the pick exercises direct control on the first holding company which in turn controls the second holding company, the latter also controlling a third holding company and so on. An interesting example is the Dutch corporate group Heineken. As Timmerman & Doorman[46] illustrate:

> "The Heineken family owns the majority of the shares in a listed holding company, which in its turn holds the majority of the shares in Heineken NV, which is also listed. Through this construction, the Heineken family effectively controls Heineken NV, even though it only provides slightly more than 25% of the capital."

A similar scenario may occur in Ethiopia, where the Commercial Code does not prohibit the control of company by means of pyramid structure. With regard to participation of one company in another company, the only limitation the Code imposes involves cross-holding between companies.[47] Article 344(1) prohibits a company (say Company A) from holding any share in another company (say company B) if company B already holds shares representing ten

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[44] The control such person excercises over the company at the bottom may either be *de jure* (contractual) or *de facto*; see Report of High Level Group EU, *supra* note 35, p.38.

[45] *Ibid*; see also Timmerman & Doorman, *supra* note 25, p.4.

[46] Timmerman & Doorman, *supra* note 25, p.4.

[47] Article 344 (1), Commercial Code reads: Where ten percent or more of the capital of one company is held by a second company, the first company may not hold shares in the second company. Cross-holdings may also raise issues of capital and control even though cross holdings do not seem to be as popular as pyramid structures. See Report of High Level Group EU, *supra* note 35, p.38.

percent (10%) or more of the capital of company A. Otherwise, a company may hold any number of shares in the other company in so far as the second company does not hold shares in the first company or where cross holding by each is below 10%.[48] No prohibition is imposed on a company's right to hold majority shares in another company and further control others indirectly.

Meanwhile, as any person is in principle capable of acquiring shares under the law,[49] the person who stands at the peak of a cascade of holding companies and ultimately controls companies thereunder may include individual person, family, individual trader (sole proprietor), partnership, company and government agency.[50]

Furthermore, contractual arrangements between shareholders may create disproportionality between capital and control. This kind of contractual arrangement is used by shareholders with relatively smaller investment compared to that of the larger shareholder. For instance, in a company where

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[48] Gizachew, *supra* note 30, p.116.

[49] This is because the Constitution of the Federal Democratic Republic of Ethiopia under Article 40 recognizes the right to private property which can only be restricted under specified circumstances. Interests or claims contained in shares (shares other than bearer shares), are regarded as movable property by the fiction of the law. A cross reference to Articles 329,697 and 729 of the Commercial Code and Articles 1260, 2816, 2829, 2863-2874 of the Civil Code reinforces this view.

[50] However, some laws, e.g. Banking Business Proclamation, *supra* note 7, provide for restrictions on one's acquisition of shares in companies. The proclamation which prohibits foreigners from acquiring shares in Ethiopian banks does also limit a person's (other than the Federal Government of Ethiopia) right to "hold more than five percent of a bank's total shares either on his own or jointly with his spouse or with a person who is below the age of 18 related to him by consanguinity to the first degree." This kind of restriction on acquisition of shares is contemplated by Articles 11-27 of the Commercial Code that state "specific requirements as to age, qualifications, sex, nationality or license may be imposed by law in respect of particular trader". Such restrictions should not be confused with restrictions imposed on certain persons to run a business.

the largest shareholder contributes 40% of the capital, other shareholders each constituting 30 % of the capital may agree to act in concert in shareholders meetings. The largest shareholder who loses control power would in fact be a minority.

To sum up, Ethiopian law does not always require capital and control to go in line. In principle, a minority shareholder seems to be anyone who contributes less than 50 % of the capital. Nonetheless, there are possibilities for such a shareholder to exercise managerial control. In a company that issues preference shares or applies pyramid structure, "minority shareholders" must be defined by taking into account such realities. Besides, definitions should take in to account contractual arrangements concluded for the purpose of acting in concert. And, it is thus submitted that minority should be defined in terms of particular situations of the company. As a United States Court interestingly remarks:

> "The question of whether shareholders are 'minority' or 'majority' shareholders should not focus on mathematical calculations but, instead, should focus on whether they have the power to work their will on others and whether they have done so improperly."[51]

2.4. Minority Shareholder under German Akt G

German law is unique in the sense that parent and subsidiaries are taken as a single economic unit – *Konzern* – subject to special rules[52] distinct from

[51] Hollis v. Hill, 232 F.3d 460 - Court of Appeals 5th Circuit 2000.

[52] The rules are provided mainly in the German Stock Corporation Act (Aktiengesetz) which dates back to 1965. They apply in relation to joint stock corporations and partnerships limited by shares (see Akt G, ¶ 291). Partnerships limited by shares are rare and therefore excluded from the scope of this paper. Some rules of the AktG are also applied by analogy to companies with limited liability (GmbH) – whose closest Ethiopian equivalent would be private limited

company law provisions that generally apply vis-à-vis majority-minority conflicts in the independent company.[53] The irrelevance of rules governing majority-minority relations in the individual company to group situations speaks of the Germany's readiness to accept commercial reality and its consequences.

German AktG, which legitimizes a wider range of controlling powers of the parent company notwithstanding they are detrimental to the interests of the subsidiary company and others,[54] embraces safeguards for shareholders of the subsidiary who have abandoned their respective interests for the sake of successful group policy.[55] Accordingly, a clearer definition of minority is sought so as to identify the beneficiaries of the protective rules.

For the obvious reason that the regime for affiliated groups expressly shifts managerial power of the controlled companies to the controlling company, the ground for the characterization of a shareholder as a minority is not the absence of control within the company he belongs to. From the very outset, a shareholder of the controlled company does not have a legitimate right to control his company. Instead, following the conclusion of the contract of affiliation, every shareholder relinquishes and subsumes its respective interests to the interests of the controlling company. As a result, the regime itself brings to an end to the core principle of company law that "capital and control must go in line".

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company (PLC); see Andenas & Wooldridge, *supra* note 1, p.454; also Hoffmann, D., 'Germany' *International Business Lawyer*, pp.218 *et seq.*[Hereinafter Hoffmann].

[53] See generally, Walde, T., W., 'Parent-Subsidiary Relations in the Integrated Corporate System: A Comparison of American and German Law', *Journal of International Law and Economics,* Vol.9, 1974, pp.408 *et seq* [Hereinafter Walde].

[54] Hoffmann, *supra* note 52, pp.219-220.

[55] Immenga, U., 'Company Systems and Affiliation', *in* Conard, A.,et al. (eds.) *the International Encyclopedia of Comparative Law*, Martinus Nijhoff Publishers, The Hague, 1985, Vol. XIII, Chapter 7, Part II, p.73 [hereinafter Immenga].

The subjects of the protective rules of the law are what are known as *outside shareholders*.[56] According to Ulrich Immenga, these are shareholders of the controlled company who are participating at the side of the controlling company and whose interests are likely to be affected by the management decisions of the controlling company.[57] This group generally constitutes the minority.[58] The term outside shareholder is "derived from the relationship that exists between these holders and the controlling company".[59] Among shareholders of the controlled company, the controlling company can never be regarded as an outside shareholder.[60] Also, any party associated to the controlling company and thus participates for the latter's advantages by virtue of that association is not an outside shareholder. From members of the controlled company whose interests are not endangered as a result of the relationship and are not therefore covered by the protective rules include:[61]

- a shareholder-director that is appointed by the parent company[62] and
- a company that is allied with the controlling company through special contractual regime (as per German law) or otherwise *de facto* (as per an EEC Directive).[63]

Among from shareholders of the concerned subsidiary a shareholder who either controls or is controlled by the parent company by virtue of a contract of

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[56] *Ibid*. This is also the term used in German AktG (see title of § 4).

[57] *Id*.

[58] *Id*. Immenga alternatively uses terms *external* or *free* shareholders. This is perhaps due to the fact that, though these members of the subsidiary have relinquished their control in favor of group interests, their individual interests are not necessarily in line with the interests of the group.

[59] *Id*.

[60] *Id*.

[61] *Id*.

[62] Such director is also refered to as nominee director.

[63] Immenga, *supra* note 55, p.73.

dominance or de facto may be assimilated to the class of outside shareholders. This class should however be distinguished from the one we saw above under the second category. That category consists of a company that may not be a shareholder in the subsidiary but which has alliance with the controlling company.

3. The Whys of the Protection of Minority Shareholders of the Subsidiary Company

Protection of the financial interests of minority shareholders of the subsidiary is a major objective of a law regulating parent-subsidiary relations.[64] Of course, company law protects minorities in individual companies as well. Both in the group structure and within the individual company, minority protection is meant to tackle conflict of interest problems. In group context, the conflict is between the economic interests of the parent company and that of the subsidiary. Whereas, in the individual company the conflict is between the financial interests of the minority shareholder and that of the majority, the later's interest being presumably indistinguishable from the interests of the company.[65]

Nevertheless, legal and practical issues of minority protection in an individual company and in a group relationship are basically different. In the independent company, only fraudulent practices must be addressed. On the other hand, in the group arrangement there is a group policy that subsumes the policies of its members. It is no more an individual action that affects the interests of minorities. It is rather the fact of integration that triggers the protection of minorities in corporate groups.[66] As Muscat posits:

> "At law the position of a minority shareholder in a subsidiary company should be no different from that of a minority in the single independent

[64] See also Walde, *supra* note 53, p.456.

[65] See *infra* Section 3.1 for more.

[66] Walde, *supra* note 53, p.456.

company. Yet, *in practice a minority shareholder in a subsidiary is company is potentially at greater risk.*"[67] [Italics added]

An assessment of a company law regime on minority shareholders' protection is basically an assessment of rules on conflict of interest. This section makes a general remark on some of the "greater" conflict of interest risks of minority shareholders of the subsidiary. First is however a brief summary of the tension between legal independence and economic unity.

3.1. The Tension between Legal Independence and Economic Unity

Independent legal personality of a company take as read its economic independence.[68] Such presumption is expressed in the term "corporate interest."[69] Corporate interest dictates all company law rules including those concerning internal management. Rules on directors' liabilities and validity of shareholders' resolutions are thus formulated to advance corporate interest.[70]

In the individual company, where the internal structure of corporate governance consists of a relatively independent board, pursuing corporate interest is easier. The residual corporate affairs reserved for shareholders participation are exercised through shareholders' general meetings.[71] Common to all shareholders is the desire to realize their financial interests through the continual generation of profit by their company.[72] Here, the interests of the minority are largely parallel to the interests of the majority and ultimately to that

[67] Muscat, *supra* note 4, p.17

[68] Immenga, *supra* note 55, p.6.

[69] *Ibid.*

[70] *Ibid.*

[71] Nonetheless, the scope of managerial power of the board and the shareholders' meetings differs from jurisdiction to jurisdiction; see Immenga, *supra* note 55, p.6.

[72] *Ibid.*

of the company. The interests of the company are determined on the basis of majority rule and any practical conflicts are resolved by majority voting.[73]

Nonetheless, this relative harmony in interests faces lots of problems when a company becomes a member of a corporate group and thereby surrenders its economic independence.[74] This loss of independence is usually factual instead of legal since the subsidiary is still a separate legal entity.[75] Here, the minority shareholders of a subsidiary company are in need of protection since there is a tension between the company's legal independence and economic unity within the group.[76] This tension emanates from the very attribute of groups which is characterized by the separation of economic independence from legal personality of the subsidiary company due to the control the parent exerts over its subsidiary. When we see the other side of the coin, the group is only an economic unit rather than a legal unit and company law does not usually treat the group as a legal person even though it consists of companies operating under a single economic policy.[77]

Under these circumstances, there is a shift in the management function of the organs of the subsidiary company as the management board is under outside control for all practical matters, although it is still legally unaffected. Furthermore, although the composition of board members is to be determined

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[73] *Ibid.*

[74] *Ibid.* When enterprises join together a larger economic unit is created. Such unit is assumed to be created when a certain level of centralized management is achieved. The prerequisite degree of management centralization and strength of the resultant economic unity could vary.

[75] Muscat, *supra* note 4, p.86.

[76] Timmerman & Doorman, *supra* note 25, pp.89-90.

[77] Despite the creation of economic of unit, the subsidiary still retains all the five characteristics of a business corporation: (1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contributors of capital; see Kraakman R. et al., *the Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, Oxford, 2009, 2nd ed., p.5.

by shareholders meetings, the general meeting is exposed to the influence of an outside interest in the form of majority shareholder.[78] In short, due to the inherent conflict of interest between the parent and its subsidiary, all functions of the management organs of the company end up to be mere formalities which serve only legitimate interests of the group. In other words, group relationship and the resultant conflict of interest bring about a disruption of the legal structure of authority within the subsidiary company.[79]

Beyond disruption of the legal structure of authority within a company, the conflict of interest situation created thereby may erode the finance and assets of the subsidiary.[80] For it pursues an outside interest, which is the group's interest, instead of its own, the subsidiary's business is not conducted "with an eye single to its own interests".[81] At the same time, the policy of the group may not necessarily be compatible with that of the subsidiaries'.[82] Group profit maximization does not always mean profit maximization for an individual member[83] as the subsidiary may even be expected to act to its detriment for the overall group success.[84]

3.2. Conducts of the Parent Company that may harm the Subsidiary

Formation of corporate group brings with it "some risks of abuse and unfairness that could endanger the various interests,"[85] mainly the interests of minority shareholders of the subsidiary. Due to excessive intervention and

[78] Immenga, *supra* note 55, p.6.

[79] *Ibid*; see also Muscat, *supra* note 4, p.49.

[80] *Ibid*, p.7.

[81] Muscat, *supra* note 4, p.66.

[82] Timmerman & Doorman, *supra* note 25, p.89-90; see also Immenga, *supra* note 55, p.4.

[83] Immenga, *supra* note 55, p.6.

[84] Muscat, *supra* note 4, p.65.

[85] *Ibid*, p.47.

domination by the parent company, [86] the subsidiary is compelled to behave in a way that is detrimental to itself but beneficial to the group as a whole or for one or more other group members. While the organization of companies into a group form generally allows the parent to transfer profits and assets and to divert business opportunities, abusive corporate practices simply aimed at implementing the group's goal of profit maximization may not necessarily result from domination – even of the extreme type – by the parent. [87] Control power is a power that is almost by definition granted to every parent company[88] and under normal circumstances, it is applied for the overall success of the group as a whole without endangering the interests of minority shareholders of subsidiaries.[89]

Abusive corporate practices include profit transfer, transfer of assets and business opportunity diversion. Though economically rational and consistent with good business practice, these practices may at the same time be prejudicial to the interests of the subsidiary and its minorities.[90]

3.2.1. Profit Transfer

The parent company may tunnel profits that its subsidiaries earn through intra- group transactions including *transfer pricing*. Transfer prices are prices fixed by the parent and have no relation to market value.[91] Transfer pricing is

[86] *Ibid*, pp.61-62. In terms of the degree of influence the parent exerts on them, subsidiaries could be autonomous, coordinated or dominated subsidiaries. The abusive conducts discussed in this article are observed in the dominated subsidiary; see generally Immenga, Company Systems, p.66.

[87] *Ibid*, p.61-62; Immenga, *supra* note 55, p.66.

[88] *Ibid*.

[89] *Ibid*, p.62; Immenga, *supra* note 55, p.66.

[90] *Ibid*, p.68.

[91] *Ibid*; Immenga, *supra* note 55, p.7.

commonly applied in sale transactions where the parent and its subsidiary have vertical relationships as customer and supplier.[92] Transfer prices are often set by the parent company without regard to the market value of the commodity involved.[93] The inadequate price paid by the parent or the excessive charge imposed on the subsidiary may bring about a reduction in income and perhaps eventually bankruptcy to the subsidiary.

Although transfer pricing is effective and thus frequently used in transferring profits, loans extended to the parent or other group members at less than the market interest rate may also be employed for similar end.[94] Likewise, payments made to the parent or other group members as a consideration for services such as research may in fact result in profit transfer.[95]

3.2.2. Transfer of Assets:

When parent-subsidiary dealings cross the red line of normal commercial transactions, transfer of profits becomes transfer of assets. Transfer of assets is the appropriation by parent company of the essentials of its subsidiary.[96] It occurs when, for instance, the parent company demands the conveyance of assets

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[92] A steel producing parent company having an interest in a coal producing subsidiary may, for instance, fix a lower (than the actual value in the market) price for it wants to assure a sustainable supply of coal from the subsidiary. Similarly, "if this steel producing parent has an interest in another company that uses large quantities of steel, for example, a car manufacturer, the steel producing company fixes a higher price for long term basis for the steel it sells"; see Lutter M., 'The Konzern in German Company Law', *Journal of Business Law*, 1973, p.278.

[93] Immenga, *supra* note 55, p.7.

[94] *Ibid*, p.7; Muscat, *supra* note 4, p.69.

[95] *Ibid*; Muscat, Muscat, *supra* note 4, p.69.

[96] Immenga, *supra* note 4, p.7.

whose values do not have reliable market standards – intangible assets such as patent and know-how are typical examples.[97]

In the worst case scenario, the parent company may demand the sale of immovables or machineries owned by the subsidiary.[98] A continual payment a subsidiary makes in return for a long term deal with its parent (e.g. lease of an obsolete machine from the parent) can also lead to transfer of assets.[99]

3.2.3. Diversion of Business Opportunities

After undertaking feasibility and other important studies, the subsidiary company could make an agreement with a customer to perform a certain project which, after the deal, must often be reported to the headquarters of the group. Upon learning about the project, the parent company might divert this business opportunity to another group member, perhaps to give some incentive. In the meantime, the first subsidiary suffers loss of opportunities since prospective customers are likely to deal with that other group member. Loss of projects and the consequent absence of customers may diminish the subsidiary's income.[100]

4. Minority Shareholder Rights

A shareholder qualifying as a minority shareholder is entitled to some specific rights and actions.[101] This section discusses the nature of minority rights

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[97] *Ibid.*

[98] *Id*; Muscat, *supra* note 4, pp.76-78.

[99] *Id.*

[100] Muscat, *supra* note 4, p.73.

[101] For example under Article 381(1), Commercial Code, shareholders constituting 10% of the capital may request the Ministry of Trade and Industry to appoint one or more qualified inspectors and to make an investigation and report on the company's state of affairs. In the context of group companies, these shareholders may bring an action for investigation into

as distinguished from other shareholders' right. In doing so, it first elaborates on "the rights of shareholders" as recognized under the *OECD*[102] *Principles of Corporate Governance* (2004),[103] the 1960 Commercial Code of Ethiopia and the 2006 UK Company Act. Finally, we conclude that not all rights including some fundamental shareholder rights are truly minority rights.

4.1. Rights of Shareholders

The 2004 OECD Principles of Corporate Governance ideintifies some six basic shareholder rights. These are the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) a share in the profits of the corporation.[104]

These rights may be categorized into pecuniary rights and control rights. Pecuniary rights primarily address how shareholders share in the profits during the life time of the company and the property upon dissolution. The right to control, on the other hand, deals with the manner and extent to which shareholders exercise voting in the affairs of a company.

the affairs of their company (the subsidiary). Further, such an investigation may be extended to the affairs of holding companies and other subsidiaries (Article 384, Commercial Code).

[102]OECD stands for Organization for Economic and Co-operation and Development. It is an economic organization of over 30 nations that coordinate trade and economic policies of member states. Its principles are used as benchmarks by lawmakers of both member and non-member states; see <http://www.oecd.org/about/>.

[103]OECD Principles of Corporate Governance, 2004 [hereinafter as OECD Principles].

[104]OECD Principles, p.33. These rights are recognized in virtually all member states of OECD. As we will see below, the Commercial Code of Ethiopia also embraces these basic rights.

This classification is also reflected on the OECD basic principles of protection.[105]

With respect to the right to control, the OECD Principles consists of the shareholder's right to information and the right to influence the corporation, primarily by participating and voting in general meetings.[106] As a rule, shareholders' rights to control are inherent to one's membership in (investment) in the company. All shareholders, regardless of the number of shares they hold, are entitled to these rights. Moreover, without a shareholder's consent, the rights are not subject to decisions of all levels of management of the company.

Though capital investment in principle entitles every shareholder to influence his/her company's affairs, stretching one's hand into each and every business of the company is unrealistic. Pragmatism – the diversity of shareholders' interests and the resultant impossibility to manage the company by shareholders' referendum and the need for speedy management decisions[107] – limits shareholder's rights to influence the company only to certain core issues[108] related to, for example, the appointment of board members, approval of extraordinary transactions, and amendments of the company's articles or memorandum of association.

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[105] OECD Principles, p.32. Accordingly, an equity share in a publicly traded company can be bought, sold, or transferred. An equity share also entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting.

[106] In addition to these rights that are recognized under the laws of all OECD member states, shareholder rights related to the approval or election of auditors, direct nomination of board members, pledging shares, the approval of profits, etc., can be found in various jurisdictions. See OECD Principles, p.32.

[107] *Ibid.*

[108] *Ibid.*

Also, though core issues of management are always subject to majority vote, right to control may not necessarily be exercised democratically – i.e. through the shareholders' general meeting.[109] Instead, the right may be exercised indirectly through the appointment or removal of members of the board of directors who pass decisions on day to day affairs of the company.[110]

4.2. Shareholders' Rights and Management

The supreme organ of corporate management is the shareholders' general meeting.[111] The ultimate power of management and control of the company resides with shareholders acting collectively in general meetings – which may be ordinary or extraordinary.[112] Shareholders meeting as an organ of management

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[109] Though the six basic rights identified by OECD concern every shareholder including the minority, the ultimate decision maker is the majority shareholder through legitimately held general meetings. It is the majority's wills that are deemed to be the will of the company and of all of its members including the minority shareholders. This is also true in times of disagreement between the minority and the majority. Under Ethiopian law, a shareholders' general meeting properly established and conducting its business in accordance with the law, acts on behalf of all shareholders; its decisions bind all shareholders whether absent, dissenting, incapable or having no right to vote (see Articles 388(1) - (2), Commercial Code). This rule applies *mutatis mutandis* to special meetings as well.

[110] Even so, as will be seen next, the six basic shareholder rights cannot be set aside by any organ of the company as well as articles or memorandum of association.

[111] There are different categories of meetings, but generally the shareholders as a whole must meet at least once per annum to evaluate the performance of directors, managers, auditors and the overall state of affairs of the company. And whenever urgent and crucial matters that are beyond the scope of powers of board of directors arise, extraordinary meetings will be held.

[112] Ordinary and extraordinary meetings are general meetings because all shareholders are entitled to participate in them. On the other hand, special meetings refer to meetings of shareholders of a specific class. There might be several classes of shares; and matters that only affect specific class of shareholders need special meeting of concerned shareholders.

plays significant role by passing resolutions on top issues of management. It has powers to supervise the directors and to decide on the ultimate management issues including winding up. All other management organs including directors are accountable to shareholders meetings.[113] However, this privilege of shareholders is limited to cases where the company remains a going concern: in times of insolvency creditors will have their own say in decision making.[114]

Decisions of the general meeting of shareholders, which obviously reflect the will of the majority, bind all shareholders including the minority. Notwithstanding this, shareholders' fundamental rights reign supreme. Neither the general meeting of shareholders nor the board of directors may pass resolutions that compromise shareholder rights "inherent in membership." Similarly, neither the constitution of the company nor the articles of association should preclude a shareholder from enjoying fundamental rights: for example, right to vote in a general meeting[115] and right to a share in profits. Article 389(1), Commercial Code plainly states that "[any resolution by corporate management organs] *may not deprive a shareholder of his rights inherent in*

[113] Ethiopian law provides three organs of management: shareholders meetings, directors and auditors. Additionally, general manager who, while not an organ *per se*, plays crucial role in the management of the company. While shareholders meeting retain power as regards significant corporate matters, the board and the manager exercise residual powers of management.

[114] Wymeersch, E., 'Current Company Law Reform in the OECD Countries: Challenges and Opportunities', *Financial Law Institute Working Paper No. 2001-04*, Financial Law Institute, Universiteit Gent, 2001, p.1; . See also Articles 974 *et seq.,* Commercial Code.

[115] Exceptionally, a shareholder may be precluded from voting in a shareholders' meeting. Concerning legal prohibitions, an excellent example is the rule that prohibits a majority shareholder (for our purpose, a parent company) from casting its vote in resolutions pertaining to the approval of conflicted transactions(Article 409 (1), Commercial Code). Moreover, a shareholder who gets his investment back by way of dividend shares cannot vote in certain general meetings. Still, such restriction is consensual which follows one's entitlement to benefits.

membership". Rights inherent in membership, which consist of control and pecuniary rights, include:

> "rights which, under the law or the memorandum of association, do not depend upon decisions of the general meeting or board of directors or which are connected with *the right to take part in meetings, such as the right to be a member, to vote, to challenge the decisions of the company or to receive dividends and a share in winding up*."[116] [Italics added]

4.3. What are Minority Rights?

In the protection of minority shareholders, both personal rights of the shareholder and rights of the company play important roles.[117] Personal rights are rights that emanate from the shareholder's personal capacity as a member to the company. The source of the rights may be the law, the articles of association or the memorandum of association.[118] Such rights may be protected by personal actions which in many cases are brought against the company itself; hence, their

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[116] Article 389(2), Commercial Code; the fundamental shareholder rights are also recognized elsewhere. For instance, the 2006 Company Act of the United Kingdom extends these rights to all shareholders, regardless of the number of shares they hold. Similarly, Dutch law recognizes rights identical to what under Article 389 of the Commercial Code termed as "rights inherent in membership". See generally United Kingdom Company Act, 2006 and also Timmerman & Doorman, *supra* note 25, p.5.

[117] Joffe, V. et al., *Minority Shareholders: Law, Practice, and Procedure,* 3rd ed., Oxford University Press, Oxford, 2008, p.2 [hereinafter Joffe].

[118] *Ibid*; this is true for the minority under UK and Ethiopian law. For the minority in the German contractual group, the source of the right is the contract of control. See below for more on this.

enforcement through personal suits.[119] The six basic shareholder rights discussed above are all personal rights.

Conversely, a shareholder may seek to enforce rights not vested in him, but rights vested in the company. For example, a shareholder may seek a remedy against directors for fraudulent misappropriation of the company's assets[120] via derivative action (if there is any).[121] In derivative action, the shareholder seeking protection raises the claim in the name of the company because the right to be enforced is of course the right of the company. Our discussion in this section (or article in general) is however limited to personal rights of minority shareholders.

As discussed earlier, the six basic shareholder rights –which are also personal rights – are inherent to membership and inalienable. They are equally enjoyed by all shareholders regardless of the number of shares they possess. Even a shareholder with a single share is vested with the rights. Yet, not all of these rights are truly minority rights. The right to participate or vote in general meetings, for example, usually does not qualify as a minority right. Although every shareholder has an inherent right of membership to participate in ordinary general meeting, some shares (e.g. dividend shares or preference shares) may be issued without voting right. Even where shares are issued with voting rights, the right to vote per se is not truly a minority right. For one thing, the right is not specifically destined to the minority. Second, the right does not play a significant role for the minority; since in times of disagreement they are the ones to be outvoted by the majority and to lose.[122] Put simply, even though the general meeting cannot preclude a minority shareholder from participating and

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[119] *Ibid*. p.71.

[120] *Ibid*, p.2.

[121] Derivative action is allowed under Ethiopian law. Shareholders representing 20% of the capital are allowed to enforce the company's right against directors where their company, after a vote for institution of action against directors for their liability to the company, takes no action within three months of the vote (Articles 364 – 365, Commercial Code).

[122] Timmerman & Doorman, *supra* note 25, p.5.

voting in the meeting, the right to participate or vote in itself does not normally let decisions otherwise than what the majority desires.

In group context, especially in simple parent-subsidiary relationships, minorities of the subsidiary company are vested with the right to participate and vote in their company's general meetings. Likewise, the parent company –as a shareholder of the subsidiary – is vested with the same rights. Because the parent company[123] more often than not exercises its majority vote in general meetings, these rights are of less significance for the minority of the subsidiary. By the same token, the right to receive a dividend per se is not a minority shareholder's right;[124] this is because the right does not normally allow reversion of a legitimately passed resolution on the destination of profits.[125]

In view of the foregoing, basic shareholder rights may be distinguished from minority shareholder rights. "For a right to be a true minority right," Timmerman and Doorman colourfully explain: absolute

> "it needs to possess the characteristic that it creates the possibility that an outcome can be reached that is different from the outcome that the majority of the shareholders wish. This means that the minority shareholder can interfere through a minority right in the affairs of the company, thereby correcting the policies of the majority shareholder."[126]

Therefore, a shareholder's right to qualify as a true minority right must:

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[123] Of course, it is the presence of this almighty as well as any others (which make a shareholder maker or breaker of the subsidiary's business) that accrue to such shareholder the status of a parent company.

[124] Ethiopian law confers on the shareholder a right to a share in annual net profits. But the ultimate decision on whether or not there will be distribution of profits and how much is made by annual general meeting of shareholders; hence, the right to share in net profits appears conditional than absolute (See Articles 419(1) *cum* 345(1), Commercial Code).

[125] Timmerman & Doorman, *supra* note 25, p.5.

[126] Timmerman & Doorman, *supra* note 25, p.6.

a. create the possibility for the minority to see a resolution other than the wish of the majority.
b. allow the minority to interfere in the affairs of the company; and, such interference, if there is any, must be by virtue of the right itself.

A true minority right is one that really enables minority shareholders beyond mere participation or voting in the general meeting. It must, for example, entitle the minority to challenge and rectify the policies as well as resolutions of the company – i.e. the majority. Mere possibility for the minority to see decisions otherwise doesn't make a right a minority right unless such interference of the minority is "by virtue of the right itself".

Take for example take the shareholder's right to get dividend. The majority shareholder cannot deny a minority shareholder of this right without the latter's consent. However, the power to declare dividend on annual basis belongs to the general meeting, i.e. the majority.[127] The minority shareholder cannot basically persuade the general meeting to declare dividend by invoking his right to get dividend. And, it is only where a decision for dividend precludes minorities from getting their share that the law renders such a resolution void.

Otherwise, the law protects minorities from only unreasonable or unfair decision to retain earnings (instead of distributing dividend). In the Netherlands, where the general meeting of shareholders is considered *bona fide* of (minority) shareholders,[128] there hase been a tendency to rely on "abuse of majority power doctrine" in protecting minorities – this is particularly the case since the 13 February 1942 Supreme Court judgment in *Baus v. De Koedoe*.[129] *Van Rees v. Smits*[130] an incisive example of the application of this principle. In setting aside a

[127] Article 419(1), Commercial Code.

[128] Timmerman & Doorman, *supra* note 25, p.6.

[129] *Ibid*.

[130] Court of Appeal, The Hague, 1 October 1982, NJ 1983, 393 cited in Timmerman & Doorman, *supra* note 25, p.6.

decision of the general meeting of shareholders to retain dividend, the court emphasized the importance of establishing whether "the general meeting of shareholders in the light of the mutual interests and arguments could have reasonably come to this decision". Accordingly, the Court declared the decision of the general meeting of shareholders void for it was unreasonable because of the large reserves, the profit in the year in question, the good performance in the next year and because it had been customary to declare a dividend of 50% of the profit.[131]

When we look into the relevant[132] Ethiopian laws, it is not clear whether the majority shareholder (parent) owes comparable duties to the minority. Of course, extraordinary transactions entered into by directors of the subsidiary are ultimately subject to general meeting authorization.[133] For the purpose of group relations, extraordinary transactions include dealings made between a subsidiary company and a parent director[134] and also dealings made between the subsidiary company and another concern.[135] Nonetheless, a dominant shareholder – for

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[131] *Ibid*. In a similar fashion, UK company law protects minority shareholders from certain company decisions through "unfair prejudice remedy"; See Hollington, R., *Minority Shareholders' Rights*, 3rd ed., Sweet & Maxwell, London, 1999, p.1[hereinafter Hollington].

[132] As has just been noted, minority protection in group arrangements focuses on the regulation of intra-group transactions; and, shareholder's duty towards the subsidiary should therefore be seen mainly from the vantage point of the rules regulating shareholders' approval procedure regarding conflicted transactions.

[133] Once interested party transactions have been approved by the board of directors, the general meeting decides on the fate of such transaction by either approving (sometimes with modification) or disapproving it. See Articles 356(1)-(3), Commercial Code.

[134] This is applicable to dealings made directly or indirectly. For example, transactions entered into via an agent are subjected to the authorization procedure.

[135] Such concern may be a physical or legal person (e.g. another company) which is not acting as a director in the sense of Article 356(1). For the purpose of Article 356(2), it is enough that at least one of the directors of the subsidiary company is a director, manager, agent or

our purpose a *de facto* parent – usually imposes its will on the general meeting of shareholders that monitors extraordinary transactions. This is done by approving a transaction that is detrimental to the subsidiary company and its minority shareholders.[136] As a result, the Commercial Code protects the minority shareholders by restricting voting rights of some shareholders (e.g. the parent) whenever there is conflict between the interests of the shareholder and those of the company.[137] However, the parent's violation of this restriction does not in itself vitiate a resolution that approves extraordinary transactions. It is if and only if the violation results in approval of a transaction that is prejudicial to the subsidiary that the minority may seek the setting aside of the resolution.[138] On the other hand, Article 356(4) provides "dealings approved by the meeting may only be set aside on the ground of fraud". It thus appears that courts may not set aside the transaction on the sole ground of prejudice unless fraud (deceit) on the part of the majority is involved. It is thus suggested that fraud is the only restraint of majority power under Ethiopian law.

In the light of the foregoing, the majority shareholder's fiduciary duty to either the company or to its minority shareholders is not provided for in the Commercial Code. Had fiduciary duty – comparable with the fiduciary duty of directors recognized under the Commercial Code – been imposed on the parent, it would have been easier for courts to consider the interests of the

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shareholder of that other company. See Belayneh K. Zeleke, 'Protection of Minority Shareholders in Group Structures: the Case of Ethiopia, A Comparative Study' (University of Groningen, Faculty of Law, Department of International Economic and Business Law, August 2010, Unpublished), p.33. [Hereinafter Belayneh].

[136] This happens especially where the majority shareholder (the parent) has a personal interest in the transaction. The *North-West Transportation Co. Ltd. vs. Beatty* case (cited in Belayneh, *supra* note 136, p.33-34) where the majority shareholder managed to approve a transaction that it had already made in its director capacity is an illustrative example.

[137] Article 409(1), Commercial Code.

[138] *Ibid*, Articles 409(1)-(2) *cum* Article 416.

subsidiary company and its minority shareholders in reviewing general meeting decisions regarding extraordinary transactions. But now, it is only injuries caused by fraudulent conducts that trigger the parent company's liability. Minority shareholders of the subsidiary company cannot thus get court relief for injuries caused by negligent or unwise managerial decisions of the parent company. Therefore, it is submitted that the merits of extraordinary transactions approved by a general meeting resolution would not be reviewed in Ethiopia; and, it is only if such a resolution is an outcome of fraud that the courts would interfere in wills of the majority.

In contrast to Ethiopian law, the AktG provisions on outside (minority) shareholder protection seem to be more precise and clear. Though the duties imposed on a controlling company towards the controlled company and its minority shareholders differ depending on whether the group is contractual or de facto, the parent's main obligation towards the minority shareholders of the controlled company involves a pecuniary one: the controlling company is duty bound to compensate the minority shareholders on annual basis. The compensation is calculated on the basis of dividends paid in the past and of realistic future income expectations.[139] As regards *de facto* groups, the main obligation of a parent company is to refrain from any act which might be of any negative consequence to the dominated company. As opposed to contractual arrangements vis-à-vis which the law allows the controlling company to even take disadvantageous measures against minorities of the subsidiary, *de facto* groups are subject to rules which prohibit the controlling company from taking

[139] Akt G, ¶ 304(2); the protection accorded here must be distinguished from those recognized under Ethiopian and comparable UK laws. In Ethiopia and UK, minority shareholders may bring derivative action suits to enforce the rights of their company in order to indirectly protect their financial interests. Whereas, in Germany, the law affords minority protection in the form personal right directly enforceable against the parent company. This seems the reason why the controlling company has two lines of obligations as a rule: one owed to the controlled company itself and another owed to the latter's minority shareholders.

measures that disadvantage minorities.[140] Even so, disadvantageous acts may be taken upon the fulfillment of one condition. Pursuant to ¶ 311(1), Akt G, the controlling company can take measures of negative consequences provided they are reimbursed within a year time.

Conclusion

Control power the holding company exercises in shareholders meetings, the right to appoint or remove the board of directors of the subsidiary company, and limited liability are the main incentives for the parent company to do business in group structure. On the other hand, a subsidiary company's membership to a corporate group brings about a disruption in the legal structure of authority within the subsidiary; and, this paves the way for the parent to take measures that jeopardize the financial interests of the subsidiary's minority shareholders.

This paper reveals that the core target of the parent company is group success; and its policies are often tuned by this assumption. The measures it takes could generally benefit the group as a whole, or one or more members of the group. Yet, it may also adversely affect a particular subsidiary. Since the subsidiary's minority are basically interested in the solvency of their company, measures of this kind become sources of conflict. Thus, certain conducts of the parent company towards its subsidiaries call for special attention so as to protect the financial interests of the latter's minority shareholders.

To that end, some countries (e.g. Ethiopia, UK, and numerous European states) rely on traditional company law remedies. In some jurisdictions, like

[140] This obligation appears to flow from the principle set forth under ¶ 311(1), Akt G that all transactions within a factual group must be at arm's length. Note that the 'at arm's length' principle is not applicable as regards contractual groups. See generally Hoffmann, *supra* note 52.

Germany, Portugal and Brazil, special laws govern matters pertaining to groups of companies. In Ethiopia, where big companies doing business in the "group" form are mushrooming in response to the reintroduction of free market in the early 1990s,[141] the Commercial Code recognizes group relationships having share companies as their ingredients. Yet, the Code's recognition of the "group" form is not coupled with a provision stipulating the threshold or mode of control that a company should (potentially or factually) exercise over another company(ies) for such entities to have control relationships. One cannot thus easily identify the subjects of the obligations and rights provided in the Commercial Code vis-à-vis corporate group members.

Tough the Code purports to protect the minority shareholders of the subsidiary, it is difficult for courts to apply the special protective rules without first identifying who minority shareholders are. In the absence of express statutory rules defining minority, it is submitted that minority shareholder should be understood as a shareholder who irrespective of his shareholding in the company is unable to exercise a significant control within the company. By significant control, we mean one's decision making power in the shareholders general meeting or one's power to appoint or remove the majority of the subsidiary's board of directors. Therefore, in the absence of control within his company a shareholder who holds fifty percent or more of the voting rights of the company must qualify as a minority shareholder. In Ethiopia, where capital and control are not required by law to be in line, a definition of "minority shareholders" should also take into account instances where (1) a shareholder (who has contributed relatively small portion of the capital) exercises managerial control, and (2) a company issues preference shares or applies pyramid structure.

Finally, minority shareholder rights must be distinguished from fundamental shareholder rights. For a shareholder's right to qualify as a true minority right,

[141] Tilahun Teshome, 'Some Notes on Ethiopian Company Law', *Tiret: The MIDROC Ethiopia Group Magazine*, Vol.15, No.2 (March 2001), p.47.

two cumulative requirements should be met. First, such a right must create a possibility for the minority to see a resolution other than the wish of the majority. Second, the right itself should allow the minority to interfere in the affairs of the company; the existence of other grounds entitling the minority to see decisions otherwise than what the majority wishes does not make a right a minority right.