Managers' Power, *Ultra vires* and Third Parties under Ethiopian Law: a Critique of *Ethiopian Mineral Development SC v GTT Trading*[*]

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1. Synopsis of the Case

Ethiopian Mineral Development Share Company [hereinafter, EMD], a public enterprise converted into a share company for privatisation purposes, as per the Privatisation of Public Enterprises Proclamation[1] [hereinafter, the Privatization Proclamation], had a supply contract with GTT Trading. This contract was later cancelled unilaterally by the former. Subsequently, a dispute arose over the legality of the unilateral cancellation of the contract by EMD. As Art 10(4) (2) of the contract envisioned arbitral settlement of disputes arising out of the contract, GTT Trading proceeded to appoint arbitrators with a view to set arbitration in motion. Yet, EMD did not appoint arbitrators, an act which delayed the arbitration process. As a result, GTT Trading approached the Federal First Instance Court to appoint arbitrators on behalf of the dilatory EMD.[2]

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[*] *Ethiopian Minerals Development SC v GTT Trading,* Federal Cassation *Chilot*, Cassation File No. 30727 [Ginbot 19, 2000 EC].

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[1] A Proclamation to Provide for the Privatisation of Public Enterprises, Proclamation No. 146/1998, *Federal Negarit Gazeta of the Federal Democratic Republic of Ethiopia*, 5th Year No. 26, p. 933 *et seq.* [hereinafter the Proclamation].

[2] As per Art 3344(1) of the Civil Code, a party to an arbitration agreement may demand judicial enforcement of the arbitration agreement if the other party refuses to perform the acts required for setting the arbitration in motion. And, courts who are called upon to enforce arbitration agreements may be required to appoint arbitrators on behalf of the dilatory party; see generally, Art 316 of the Civil Procedure Code along with Art 3334(1) of the Civil Code.

Before ruling on the issue, the Court invited EMD to submit answers to the allegations. In its answers, EMD argued that (1) the disputed matter is not arbitrable, and (2) even if it is arbitrable, EMD is not bound to arbitrate as the arbitration agreement was signed, on behalf of EMD, by the general manager, who did not have the power to bind EMD to arbitration. Not convinced by the arguments of EMD, the Federal First Instance Court ruled in favor of GTT Trading and ordered EMD to select its own arbitrators so that the arbitration could proceed.

On appeal, the Federal High Court upheld the decision of the Federal First Instance Court. Yet, EMD proceeded to the Federal Cassation *Chilot* claiming that the lower courts got the law wrong.

2. Decision of the Federal Cassation *Chilot*

The Cassation *Chilot* agreed with the appellant [EMD] that the two lower courts committed errors of law. Crucially, it maintained that the ruling of the lower courts was not compatible with the articles of association of the company and the Privatisation Proclamation. Also, it held that the general manager, who according to the articles of association of EMD has the power to perform general acts of management including signing contracts, cannot however agree to bind the company to arbitration in the absence of express authorisation to do so.

3. Critique

Currently, there are two types of share companies (SC) under Ethiopian law. The first category of share companies – and, the most common – contains those constituted under the rules of the 1960 Commercial Code. The other group of share companies are those constituted under the Privatisation Proclamation. All are basically

subject to the Commercial Code. However, a share company constituted under the Privatization Proclamation is not subject to certain rules contained in the Commercial Code. For instance, the rules that (1) a share company shall not be formed until at least a quarter of the par value of the shares has been paid up and deposited in a bank, (2) a share company may not be formed by less than five members, (3) a share company shall not remain in business for more than six months after its members are reduced in number below the legal minimum (i.e. five), (4) a share company may only be managed by members of the company, and (5) the directors shall deposit as security their registered shares as is fixed in the memorandum of association, do not apply to share companies formed under the Privatization Proclamation.[3]

In *Ethiopian Mineral Development SC v GTT Trading* an issue arose as to whether general managers of share companies formed under the Privatisation Proclamation could bind the company to arbitration in the absence of express authorisation to do so. As briefed above, the Federal Cassation *Chilot* appeared to hold that they cannot. The *Chilot* reasoned that holding otherwise would be incompatible with (1) the purposes of the law, in particular the Privatisation Proclamation, and (2) the articles of association of the company. In this short critique, the author argues against the holding of the Federal Cassation *Chilot*.

3.1 Do the Commercial Code's Rules on Company Managers Apply to Companies Created by the Ethiopian Privatisation Agency?

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[3] See Art 5, the Proclamation *cum* Arts 307(1), 311, 312(1)(b), 315, 347(1) and 349 of Commercial Code.

The holding of the Court that general managers of share companies cannot bind their company to arbitration is apparently predicated on the theory that there are certain legislative purposes that would be distorted if the Commercial Code's rules regarding managers are unqualifiedly applied to share companies formed by the Ethiopian Privatisation Agency for eventual privatisation. Are there? The author doubts so.

The preamble of Privatisation Proclamation reveals that the main purpose of the law is to facilitate "the implementation of the ongoing privatisation program." A further look into Art 3 of the Proclamation indicates that the intention of the legislator is to encourage the involvement of the private sector in the economy of the state. And, it is hoped that the private sector would be encouraged to take on businesses hitherto run by the government if, for example, the would-be-privatised public enterprises are converted into share companies beforehand. Accordingly, the Ethiopian Privatisation Agency is empowered to convert would-be-privatised public enterprises to share companies, notwithstanding the rules contained in Arts 307(1), 311, 312(1) (b), 315, 347(1) and 349 of the Commercial Code.

The inapplicability of the rules contained in the above listed provisions of the Commercial Code to share companies formed under the Privatisation Proclamation is understandable when seen in light of the formation and management of share companies formed for the purpose of preparing public enterprises for privatization. As the shares of such companies are all held by the Government,[4] some rules in the

[4] *Ibid,* Art 5(2).

Commercial Code regarding formation are inappropriate.[5] Besides, some rules regarding shareholders' meetings – the most important method of decision-making in ordinary share companies – and directors are unsuitable[6] to companies formed as per the Privatisation Proclamation; and, hence, they are also deviated from. Otherwise, all other pertinent provisions of the Commercial Code apply *mutatis mutandis* to share companies formed through the conversion of public enterprises.[7]

Do the Commercial Code rules on company managers apply to share companies formed under the Privatisation Proclamation? The answer is certainly, yes. The applicability of the provisions of the Commercial Code (save those expressly declared inapplicable) is clearly spelt out in Art 5(4) (c) of the Privatisation Proclamation. Hence, Art 348(3) of the Commercial Code is applicable to share companies formed under the Privatisation Proclamation.

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[5] Obviously, the Commercial Code's rule that a share company may not be formed by less than five members is irrelevant to companies formed under the Privatisation Proclamation. Similarly, the formality requirement regarding the deposit of a portion of the par value of the shares (Art 312(1)(b), Commercial Code) is inconsistent with the simplification (in the formation of share companies) that the Privatisation Proclamation seeks to bring.

[6] One can, for instance, easily understand the unsuitability of the Commercial Code's rule that a company may only be managed by members (Art 347(1), Commercial Code) to share companies created by converting public enterprises.

[7] Art 5(4) (c), the Proclamation. Incidentally, it appears that the formation and management of share companies formed under the Privatisation Proclamation would be governed by the special rules set in the Proclamation only up until they are privatised.

The Federal Cassation *Chilot* was not apparently indifferent to the argument that Art 348 of the Commercial Code applies with regard to managers of companies formed under the Privatisation Proclamation. Yet, it appeared to maintain that the applicability of this provision would defeat the purpose of the Privatisation Proclamation. Though it is true that share companies formed under the Privatisation Proclamation are not always treated alike ordinary share companies, it is quite hard to comprehend why the *Chilot* held that the lower courts' interpretation of the law was incompatible with the purposes of the Privatisation Proclamation. A close reading of the Privatisation Proclamation does not reveal the existence of any purpose that would render the Commercial Code rules on company managers inapplicable. Rather, it indicates the intention of the legislator to subject mangers of share companies formed under the Privatisation Proclamation to the rules of the Commercial Code. Had the legislator had any intent otherwise, it would have expressly stated it. After all, it has clearly indicated which rules of the Commercial Code are applicable and which are not. In view of this, the *Chilot* should have simply decided the matter in light of the pertinent Commercial Code's rules on share company managers.

3.2 Do Managers Need Express Authorisation to Sign an Arbitration Agreement?

In the opinion of the Cassation *Chilot*, managers of share companies, in general, and share companies formed under the Privatisation Proclamation, in particular, need such authorisation. Crucially, the *Chilot* held that a provision in the articles of association

authorising the manager to generally sign contracts on behalf of the company is not enough to empower the manager to sign arbitration agreements on the company's behalf. However, a close reading of Art 348(3) *cum* Arts 34-35[8] of the Commercial Code seems to reveal otherwise.

As per Art 35(1) of the Commercial Code, the general manger is presumed to have the full power to carry out all acts of management connected with the exercise of the trade, including the power to sign contracts. The Amharic version of the Code is more express in empowering the manager. It states: "ከሦስተኛ ወገኖች ጋራ በሚገናኙ ጉዳዮች ሁሉ...ሥራ አስኪያጅ ከነጋደው ሥራ ጋር ነክነት ያላቸውን ማናቸውንም ግዴታዎች ለመፈረም...ሙሉ ሥልጣን እንዳለው ሆኖ ይቆጠራል፡፡" Two important inferences can be derived from the wording of this provision. First, mangers have the statutory power to sign *any* contracts connected with the exercise of company business. Second, they can do this notwithstanding any lack of express authorisation in the articles of association of the company, as the law regards signing contracts (connected with the exercise of the trade) as acts of management.

It is submitted that the provisions of Art 35(1) are broad enough to empower managers to sign any contracts ["ማናቸውንም ግዴታዎች"] related to the trade of the company, including arbitration agreements. The absence of express authorisation for signing arbitration agreements cannot be a convincing excuse to deny the statutorily recognised

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[8] In line with the argument presented in the previous section, these provisions of the Commercial Code are applicable to share companies formed under the Privatisation Proclamation.

general power of managers to sign any contracts related to the trade of the company.

Moreover, it is unclear why the *Chilot* held that express authorisation to sign contracts is not enough to empower the manager to sign arbitration agreements on the company's behalf. It seems that the *Chilot* considers signing arbitration agreements to be like what, in company law, are known as "significant corporate actions." In almost every jurisdiction,[9] including Ethiopia, significant corporate actions are subject to shareholder authorisation.[10] For instance, managers need express authorisation to sell or mortgage the business or immovable property belonging to the company.[11] Similarly, mergers and similar organic changes normally demand shareholder authorisation.[12] Yet, binding the company to arbitrate hardly falls in the category of significant corporate actions. Signing business contracts that contain arbitral clauses is among the most ordinary tasks of company directors and/or managers. And, such acts do not deserve to be treated differently from signing contracts that do not contain arbitral clauses, unless the arbitral clause relates to matters with respect to which applicable laws and company constitutions prevent the company from dealing in.[13] Yet, the existence of such a prohibition is not mentioned

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[9] See, e.g., Kraakman R. et al., *the Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 2004), pp. 131 *et seq*.

[10] Art 235, Commercial Code.

[11] Art 35(2), Commercial Code.

[12] *Ibid,* Arts 544, 547 and 550.

[13] See, e.g., Redfern A. & Hunter M., *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 2004), at ¶ 3-27, for a comparative overview of the law on corporate capacity to arbitrate elsewhere. Also, see Edwards V., *Ultra vires and directors' authority – an EC perspective,* 16 *the Company Lawyer* 7 (1995), at

anywhere in the judgement of the *Chilot*. Besides, the matter with respect to which arbitration is sought relates to supplies contract – which obviously relates to ordinary trade of the company.

3.3 Could the Provisions in the Articles of Association Be Invoked Against Third Parties?

Managers are required to act in accordance with the company's constitution and any governing law. With regard to the case at hand, the general manger of EMD is authorised by law "to carry out all acts of management connected with the exercise of the trade, including the power to sign any contracts." And, the articles of association of the company reaffirm the power of the general manager to generally sign contracts on behalf of the company. In addition, there appears to be no restriction to this managerial power. Hence, as it has already been argued (1) signing an arbitration contract is an act of management that does not need express authorisation; and, (2) if at all it does, the provision in the company's articles of association are broad enough to empower the general manager to bind the company to arbitration. In this particular section, it is further argued that there was even room for the *Chilot* to rule in favor of GTT Trading irrespective of express restrictions on the power of the EMD manager to bind his company to arbitration.

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202 *et seq*. for an appraisal of a current trend to specify rules that restrict the power of companies to avoid *ultra vires* transactions (e.g. arbitration agreements entered on behalf of the company by unauthorised officers), so as to protect third parties in good faith.

In both common law and civil law jurisdictions, company law restricts the circumstances in which a company may avoid transactions on the ground that its organs exceeded their power in purporting to effect it on behalf of the company.[14] This is done to balance the conflict between the interests of members of the company that the company should not be bound by acts of its officers' undertaken outside the scope of authority determined by the company's memorandum and articles of association, on the one hand, and the interests of third parties that the obligation entered upon by the company should be valid, on the other.[15]

The position of Ethiopian law with regard to the validity or avoidance of company undertakings *vis-à-vis* outsiders is not indifferent to the interests of third parties. There are rules within the Commercial Code of Ethiopia that restrict the ability of companies to avoid liability for *ultra vires* acts.[16]

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[14] See, e.g., La Villa G., the Validity of Company Undertakings and the Limits of the EEC Harmonisation, 3 *Anglo-American Law Review* 346 (1974), at 347 *et seq.*; Bourne N., *Principles of Company Law* (Sydney: Cavendish Publishing Ltd., 3rd ed., 1998), at 155 *et seq.*; Schneeman A., *the Law of Corporations and Other Business Organisations* (Clifton Park: Thomson, 4th ed., 2007), at 197.

[15] La Villa, at 347. Note that laws in numerous states favor the interest of third parties over that of members of the company. Even more, some states have replaced the rule that "third parties have constructive notice of the contents of the company's constitutional document" with a rule that "the validity of a corporate transaction cannot be called into question by anything contained in a company's memorandum or articles of association." (See, e.g., Bourne N., 158; Griffin S., *Company Law: Fundamental Principles*, London: Longman, 3rd ed., 2000, at 113 *et seq.*;).

[16] See, e.g., Arts 289, 363, and 528, Commercial Code.

First, Art 35(1) of the Commercial Code, which applies to share companies formed either under the Commercial Code or the Privatisation Proclamation, reads: "*In his relations with third parties*, the manger *shall be deemed* to have full power to carry out all acts of management..." This provision provides a presumption in favor of third parties dealing with a company. And, it shifts the burden of proving restrictions, if any, in the general power of the manager on the party who alleges it. In the case at hand, the alleging party is EMD, which alleged its general manager's power to sign arbitration agreements was restricted. Yet, EMD did not sufficiently discharge its burden of proof in this regard. Instead of producing any company document or resolution that restricts the power of the general manager to sign arbitration contracts on behalf of the company, it simply argued that its manager needed special authorisation to sign an arbitration agreement. It is regrettable that the *Chilot* subscribed to this not-so-well-founded argument. Crucially, the *Chilot* should have inferred from various pertinent provisions of the Commercial Code that restrictions on the power of managers may only affect third parties when they are entered in the commercial register.[17]

[17] Art 121(g) of the Commercial Code, which applies to share company mangers, provides that the limitation on the powers of a manager to a management of a branch or agency does not affect third parties unless they have been entered in the commercial register. For stronger reason, any limitation on the power of managers to sign contracts must not affect third parties unless entered in the commercial register. Note also that Arts 289(2) and 528(2) reinforce this assertion, as they expressly provide any provisions restricting the power of mangers (of a general partnership and private limited companies, respectively) do not affect third parties, at least unless they have not been entered in the commercial register. Similarly, there is no reason why restrictions on the powers of share company managers

Second, we may further argue that even express restrictions set on the power of the manager may not be invoked against third parties. Art 363(3) of the Commercial Code provides that any restrictions (by memorandum or articles of association and resolutions of shareholders' meeting) on the power of company directors shall not affect third parties in good faith, notwithstanding the rule under Art 120(2) that third parties are deemed to have constructive notice of facts entered in the commercial register. Arguably, Art 363(3) governs *ultra vires* transactions effected by not only directors but also managers [managing directors].[18] Also, inferences made from [arguably] applicable provisions of the Commercial Code seem to imply that *ultra vires* company transactions remain valid *vis-à-vis* third parties, notwithstanding restrictions entered in the commercial register. For instance, Arts 36(2) provides that any restrictions on the power of a manger [excepting the one stated in Art 36 (1)] may not affect third parties notwithstanding their entrance in the commercial register.[19] A

should be invoked against third parties where the restrictions are not entered in the commercial register.

[18] Assuming that the articles of association of the company specify that directors are responsible as managers of the company, any restrictions on the powers of such managing directors may not affect third parties acting in good faith (see Arts 363(2) *cum* 363(3), Commercial Code).

[19] Note, however, that Art 36 is not directly referred to by Art 348(3) of the Commercial Code and, hence, it is arguably inapplicable with regard to share company managers. Yet, it seems that the provisions of Art 36 are indirectly applicable. For one thing, Art 348(3) refers us to Art 121(g) whose provisions are similar with that of Art 36(1). For another, the rule contained in Art 36(2) is not expressly declared inapplicable by pertinent provisions of the Commercial Code, i.e., Art 348 *et seq*. Moreover, the same rule is spelt out in Art 528(2) of the

comparable provision is contained in Art 528(2) of the Commercial Code which applies to managers of private limited companies. Accordingly, provisions in the articles of association restricting the powers of share company managers may perhaps be ineffective against third parties in good faith, even if entered in the commercial register.

4. Conclusion

In *Ethiopian Mineral Development SC v GTT Trading*, the Federal Cassation *Chilot* set an unfortunate precedent that hampers the interest of third parties dealing with companies. It has done this in complete disregard of a range of statutory rules that work in favor of the validity of *ultra vires* corporate transactions effected by unauthorised mangers.

In a rather unconvincing fashion, the *Chilot* relied on the purposes – which it did not explain – of the Privatisation Proclamation to deny enforcement of an arbitration agreement. Ironically, there is no provision within the Proclamation that expressly or implicitly prohibits managers to bind their share companies to arbitration. Moreover, the holding of the *Chilot* that the manager needed express authorisation to bind the company to arbitration is incompatible with

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Commercial Code – which, of course, only applies to mangers of private limited companies. In the opinion of this writer, a similar rule must apply regarding managers of share companies. In particular, Art 36(2) must apply to mangers of share companies, or it would otherwise be a pointless provision, since pertinent provisions governing mangers of ordinary partnership, joint ventures, general partnership, limited partnership and private limited companies supersede and hence set aside the rules in Art 36(2) [see generally Arts 36, 121, 122, 242, 275, 289, 303, 528 of the Commercial Code]. And, the *Chilot* could also have relied on Art 36(2) to enforce the allegedly *ultra vires* transaction.

the statutory provisions regarding the power of company managers. Besides, the absence of any restriction on the power of the manger to sign contracts coupled with the rule that any restrictions in the power of share company managers may not be invoked against third parties in good faith should have dictated a decision favouring the validity of the arbitral clause contained in the supplies contract between EMD and GTT Trading.