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Ackim Chirwa, Levy Joseph Ngoma and U-Fuel (Z) Limited v. Mini Mart Development Corporation Limited CAZ Appeal No. 68/2021

Chanda Chungu[1]

Facts

The 1st and 2nd Appellants, Ackim Chirwa and Levy Joseph Ngoma commenced negotiations with a US Company, U-Fuel International to incorporate and register a company in Zambia. The agreement results in an agreement with U-Fuel International that the 1st and 2nd appellants shall hold 41% shares each in the Zambian entity. Of the 41% stake, both appellants had fully paid for the 31% of their respective shareholding was fully paid, whilst the remaining 10% was unpaid, by both appellants. U-Fuel International had a 10% stake, whilst the remaining shareholding was held by other stakeholders.

Thereafter, the Appellants independently and individually executed loan agreements with the Respondent, Mini Mart Development Corporation Limited. The agreement stipulated that the Respondent would furnish the sum of US$90,000 each. In return, the appellants individually pledged their shares in the Zambian entity as security in default of repayment.
A year later, the 2nd Appellant together with African Site Masters Limited and Mr. Mutale Besa (alias Christopher Besa) executed a Power of Attorney in favour of UFI in relation to voting rights and all ancillary activities including decision making arising from their respective shares in UFZ. Effectively, they voluntarily ceded their rights attached to their shares in UFZ to UFI, a fellow shareholder so that UFI could act as their proxy in all such related matters and affairs.

As it related to the loans contracted by the 2nd Appellant with the Respondent, misunderstandings arose as to the extent of involvement and attachment of liability to UFZ, and this led to the 2nd Appellant revoking the power of attorney conferred to UFI in relation to his shares in UFZ. However, at this point, the Respondent had enforced its rights on the loans by way of foreclosing on the Appellant's shares in UFZ. This was achieved by the fact that UFI which had the power of attorney as proxy on behalf of the Appellants had appointed and tasked Mr. Victor Makuza to oversee its affairs in UFZ.

It is worth mentioning that Clause 13.1 of the Loan Agreement between the Appellants and the Respondent stated that: -

> The borrower may not assign or transfer any of his rights or obligations under this Agreement without prior consent of the Lender.

The clause prohibited the Appellants, as borrowers from transferring their rights or obligations without the prior consent of the Lender. As things transpired, the Appellants passed a resolution transferring their liability in relation to the loans from the 1st and 2nd Appellant to the Zambian

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entity. In other words, the Appellants sought to have their individual and personal loans paid off by the Company.

On 26th January 2017, the Zambian shareholders of the 3rd Appellant resolved to transfer the individual liability for the loans from the 1st and 2nd Appellants to the 3rd Appellant, U-Fuel Zambia, the Zambian entity.

The issue went to another meeting of the shareholders on 31st January 2017, which was attended by Mr. Victor Makuza, who was Managing Director of the Respondent. At the said meeting Mr. Makuza acted as Chair and Secretary. According to the interpretation of the facts by the majority, the meeting of the shareholders recorded Mr. Makuza as representing U-Fuel International.

According to the interpretation of the record of proceedings, the majority of Court of Appeal were of the view that Mr. Makuza equally admitted to being the Managing Director of U-Fuel Zambia. The majority of the Court of Appeal concluded that Mr. Makuza was acting as both director of UFZ and representing the U-Fuel International which held 10% shares in the Zambian entity.

During the meeting on 31st January 2017, it was resolved to discontinue servicing the 1st and 2nd Appellants loans from the U-Fuel Zambia, Zambian entity's funds. Subsequently, following the failure of the 1st and 2nd Appellants to repay the loan, the Respondent proceeded to issue letters of demand for the repayment of the loans. When the Appellants failed to repay, the Respondent issues foreclosure notices on the shares as per the agreement between the parties. The High Court, in a judgment delivered by Mwenda J held that the Zambian entity was not a party to the loan agreement. Rather it was the 1st and 2nd Appellant and the Respondent who were the parties to the loan agreement.

The High court confirmed that as per Clause 13.1 of the Agreement, the Respondent's consent, as Lender was ceded before transferring any oblations to another party. As such the court confirmed the foreclosure on the Appellants' shares based on the non-repayment of the loan and the failure to obtain the written consent of the Respondent as required to transfer any obligations. The shareholders subsequently appealed the matter to the Court of Appeal for determination.

Holding

The majority of the Court of Appeal were of the view that there was only one decision in issue which was whether the Appellants validly transferred liability for the loans to the Zambian entity, U-Fuel Zambia.

According to the Court of Appeal, the attendance of Mr. Victor Makuza meant that he acting as both Managing Director of the Zambian entity, U-Fuel Intentional as well as being the legitimate representative of the international entity, U-Fuel International. The Court of Appeal went on to hold that: -

> It is therefore; without doubt that he rendered the advice presumably in his capacity as Managing Director of the Respondent. We state as above because, he could not do so in any other capacity as UFZ had no authority to render such advice to its owners. It is however, within the powers of the shareholders to give policy directives to the company

> as we shall demonstrate later in this judgment. But, most importantly, the advice was given on the backdrop of the sentiments earlier expressed by Mr. Makuza in Item 4 at page 182 Volume 1 of the Record of Appeal to the effect that the Loan Agreements entered into by the Appellants had no clause obligating UFZ to pay the debts from its operating income. We are therefore, of the considered view that in rendering the advice, he had in mind Clause 13 (1) of the Loan Agreements which expressly provides for written consent of the creditor.

. The Court then referred to Resolution 3 which held that: -

> UFZ to stop making Mr. Chirwa and Mr. Ngoma loan payments unless there is a written agreement by the shareholders recommending to do so.
>
> > Action point - Mr. Besa to meet with 6 shareholders and draft a written agreement on these loan payments.

According to the Court of Appeal the fact that Mr. Makuza ordered for a written agreement and endorsed his signature to the resolution means that he, on behalf of U-Fuel International consented to the transfer of liability from the 1st and 2nd Appellants to the 3rd Appellant Company. The Court of Appeal held that based on the above resolution, the transfer of liability agreement to the 3rd Appellant was valid as all the shareholders agreed to the transfer by virtue of a resolution of the company, which the majority of the Court of Appeal held was passed by all shareholders of the company.

The majority of the Court of Appeal also held that neither directors nor shareholders can interfere in each other's duties assigned by articles of association and the statute. The Court of Appeal went on to state that beyond that the shareholders take pre-eminence in determining the affairs of the Company.

Justice Nicole Sharpe-Phiri delivered a dissenting judgment wherein she held that: -

> It is thus clear that the Appellants could under the agreement assign or transfer liability to a third party, such as UFZ if written consent of the Respondent (Lender) is obtained prior to such assignment.

According to Justice Nicole Sharpe-Phiri, the loan agreement that was entered into between the 1st and 2nd Appellants and the Respondent remained in place as there was no evidence of any prior written consent of the Respondent to transfer the liability to the Zambian entity, U-Fuel Zambia. Justice Sharpe-Phiri guided that: -

> …there is no evidence that prior written consent of the Respondent was obtained indicating that it had agreed that the Appellant's liability against it could be transferred to a third party, UFZ. The only evidence before Court is of a Loan Liability Transfer Agreement which was executed by five (5) shareholders of UFZ with the exclusion of UFI. There was however no evidence of a board resolution having been secured indicating UFZ's acceptance of the debt.

In addition to the lack of consent on the part of the Respondent accepting the transfer of the debt, the Court of Appeal justice held that there was equally no evidence of any board resolution on the Zambian entity’s part accepting the debt either. On this basis, Justice Sharpe-

Phiri JA held that the liability of the 1st and 2nd Appellants could not have been transferred. She underscored the principle that parties should abide by all contracts that they freely and enter.

Significance and critique

The decision of the Court of Appeal in this matter is interesting because it is one of the few that has produced a dissenting judgment which took different approaches to the decision at hand. The majority of the Court of Appeal was of the view that Clause 13 of the Loan Agreement was satisfied because Mr. Victor Makuza who was the Managing Director of the Respondent was also acting as a legal representative of the foreign entity, U-Fuel Zambia Limited.

The majority of the Court of Appeal placed heavy reliance on 'Resolution 3' which read as follows: -

> UFZ to stop making Mr. Chirwa and Mr. Ngoma loan payments unless there is a written agreement by the shareholders recommending to do so.
>
> > Action point - Mr. Besa to meet with 6 shareholders and draft a written agreement on these loan payments.

According to the Court of Appeal the fact that Mr. Makuza ordered for a written agreement and endorsed his signature to the resolution means that he, on behalf of U-Fuel International was in rendering the advice, he had in mind Clause 13 (1) of the Loan Agreements which expressly provides for written consent of the creditor.

With due respect to the majority of the Court of Appeal, this position is not supported by the facts and evidence, as highlighted by the dissenting judgment. There is nothing from the 'Resolution 3' that indicates compliance with Clause 13.1 which requires the prior written consent of the Respondent. The mere attendance of Mr. Victor Makuza, who was Managing Director of the Respondent does not signal compliance with the prevision. Based on the basic principles of the law of contract, the failure to strictly adhere to the provisions of the contract was fatal.

It is submitted that the majority of the Court of Appeal should have sought to provide an accurate interpretation of the Clause itself. In *Barbados Trust Company Limited v. Bank of Zambia and Another*,[2] several banks provided the sum of $100 million to the Bank of Zambia under a facility agreement. The agreement stated that the debt could only be assigned to another bank or financial institution with the prior written consent of the Bank of Zambia. The Bank of Zambia failed to give such consent within fifteen (15) days. At the expiry of this period and without the consent of Bank of Zambia as required the debt was assigned to the Bank of America.

A borrower defaulted on repayment of the loan. As a result, the claimant, Barbados Trust Co ltd, as an ultimate assignee brought an action against the Bank of Zambia to recover the loan. The respondent bank argued that it did not express consent to the assignment of the debt to the appellant. So, the assignment was invalid.

The Court of Appeal held that there was no consent. The Court stated that following:

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[2] (2007) EWCA Civ 148.

> ‘Such consent’ means ‘the consent of the Borrower’. An oral consent would not be sufficient. If only an oral consent was given then, after 15 days from the request, the Borrower's consent will be deemed to have been given. It is not the Borrower's ‘written’ consent which is deemed to be given. And, in my view, it is certainly not the Borrower's “prior” consent which is deemed to have been given. Why, I ask rhetorically, would the drafter be deeming that a “prior” consent had been given? Prior to what? It does not seem likely to me that those responsible for the drafting had in mind that an assignment which was ineffective because of lack of prior written consent becomes effective because of the deeming provision from the date of the assignment (Waller LJ) or from the 15th day after the request for consent (Rix LJ).

The court heavily placed reliance on the interpretation of the clause and following the exercise of ascertaining the meaning of prior written consent, held that consent was not given. In my view, the majority focused on the wrong issue and tackled the matter in an incorrect manner. It is for this reason that the dissenting decision delivered by Justice Nicola Sharpe-Phiri JA is preferred over the decision of the majority delivered by Justice Siavwapa JA.

Significantly, the Court of Appeal delved into a discussion as it relates to corporate governance, particularly the division of powers between the shareholders and directors. The majority of the Court of Appeal felt compelled to do so based on the attendance at the meeting of Mr. Victor Makuza who was Managing Director of the Zambian entity, U-Fuel Zambia. The majority of the Court of Appeal sought to clarify whether Mr. Makuza as a mere director could give instruction to, and disagree with shareholders, notwithstanding that he attended the shareholders’ meeting, representing a shareholder.

This is however a misdirection as Mr. Makuza, despite being a Managing Director of the Zambian entity and the Respondent, was attending as a representative of the shareholder, and signed the resolution in his capacity as a shareholder. As outlined above, his signature to the resolution cancelling the transfer of liability did not translate into prior written consent as required by Clause 13.1 of the Loan Agreement. In any case, the said Resolution 3 did not even resolve or agree to the liability.

It should be mentioned that the decision of the Court of Appeal was squarely an issue within the realm of the law of contract. However, the majority of the court decided to delve into the controversial issue of corporate governance. Whilst the author is of the opinion that this was not necessary, the Court of Appeal has presented an excellent opportunity to give an overview of the correct position as it relates to corporate governance in Zambia. The Companies Act now clarifies the legal position with regards to the power of management and the ultimate decision-maker on the affairs of the company.

There are two theories or views relating to the shareholders powers. On the one side, there is view that there should be a complete separation of powers between the shareholders and the directors. On the other hand, some view the fact that because shareholders have beneficial ownership in the company, they should be able to have full control over the directors.

Under the first theory, shareholder powers that there is there should be a complete separation of powers between the shareholders and the directors. This view prioritises the notion that shareholders and directors have different roles to play in the affairs of the company and to allow each party to exercise its role effectively and efficiently, they should be given autonomy to properly perform their tasks.

Owen J in *The Bell Group Limited (in liquidation) v. Westpac Banking Corporation*[3] explained the role of a director in corporate governance as follows:

> There are various organs that influence the decision-making processes of a corporation and which are involved in corporate governance. But primary governance responsibility lies with the board of directors. In formal terms the directors are appointed by, and are accountable to, the body of shareholders. As a general rule, it is the directors who are 'the directing mind and will of the corporation, the very ego and centre of the personality of the corporation': *Lennard's Carrying Co Ltd v. Asiatic Petroleum Co Ltd* (1915) AC 705, at 713. The power to manage the business of the company has been delegated to the directors**.**

The case emphasises that the shareholders of the company delegate the power of management to the directors and only those directors are entitled to exercise powers of management. The directors are appointed by the shareholders and accountable to them but that is the extent of the shareholders' role.

In *Burnes v Pennell*[4] the appellant had attempted to deny liability on a contract to take shares in a joint stock company, an insurance company, based on a fraudulent misrepresentation he alleged had been made by a shareholder of the company — a misrepresentation that he argued bound the company. The House of Lords held that individual shareholders had no actual or apparent authority to bind the company. Lord Campbell stated that:

> All who have dealings with a joint stock company know that the authority to manage the business is conferred upon the directors, and that a shareholder, as such, has no power to contract for the company.

In *Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cuninghame*,[5] the shareholders in a general meeting, by majority, purported to resolve to sell all the company's assets. The constitution of the company did give shareholders the power to make such decisions, but only by special resolution. No such resolution had been passed. The directors declined to give effect to the resolution, and the court refused a declaration requiring them to do so. Similarly in *Black White & Grey Cabs Limited v. Fox*,[6] a majority decision of the shareholders in a general meeting purported to pass a resolution to restrict ownership of taxis by members to a single vehicle. The resolution was held to be invalid, as the matter regulated was solely with the sphere of directors.

In *Scott v. Scott*[7] the shareholders of a private company passed resolutions in a general meeting to pay dividends and appoint auditors to investigate the financial affairs of the company. The articles of the company assigned the power to declare dividends and the management of the business to the directors. The resolutions were held to be invalid. The court held where a matter is purely executive or managerial, the court will regard the power as exercisable only by the directors and not the shareholders.

[3] (2008) WASC 239.
[4] (1849) 2 H.L.C. 497.
[5] (1906) 2 Ch 34.
[6] (1969) NZLR 824 (CA)>
[7] (1943) 1 All E.R. 582.

In the seminal case of *John Shaw and Sons (Salford) Limited v. Shaw*[8] it was held that the power of management of the company is vested in the directors and only they can exercise these powers. The oft-cited view of Lord Greer reads as follows: -

> A company is an entity distinct…from its shareholder and directors. Some of its powers may, according to its articles, be exercised by the directors; certain others may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles, in the directors is by altering their articles, by refusing to re-elect the directors whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the Articles in the general body of the shareholders.

The court in *John Shaw and Sons (Salford) Limited v. Shaw* took a different view to that of the quartet judgments mentioned above. The court was of the view that directors should exercise powers assigned to them and shareholders should exercise powers reserved for them – neither party can override the other.

In *Charter Oil Co Ltd v. Beaumont*[9] it was stated that members do not have a right to manage the company. The position was earlier developed in *Gramophone and Typewriter Ltd v Stanley*[10] where Buckley LJ held as follows:

> even a resolution of a numerical majority at a general meeting of the company cannot impose its will upon the directors when the articles have confided to them, the control of the company's affairs. <u>The directors are not servants to obey directions given by the shareholders as individuals; they are not agents appointed by and bound to serve the shareholders as their principals.</u> They are persons who may by the regulations be entrusted with the control of the business, and if so entrusted they can be dispossessed from that control only by the statutory majority which can alter the articles. Directors are not, I think, bound to comply with the directions (of the shareholders) even of all the corporators acting as individuals.[11]

Buckley LJ's statement confirms the position that any ordinary resolution or shareholders' decision that seeks to give directions to the directors is ineffective and without effect.

As it relates to the second theory that shareholders have full control over directors and can override their decisions, in earlier cases such as that *Marshall's Valve Gear Co Limited v. Manning Wardle and Company Limited*,[12] the court held that the shareholders of a company have an inherent right to supervise directors by ordinary resolution, unless the articles of association provided otherwise.

Prior to the enactment of the Companies Act, a series of cases held that shareholders could override decisions of directors. The leading case in this regard was the case of *Van Boxtel v Gerardus Adrianus van Boxtel v Rosalyn Mary Kearney (a minor by Charles Kearney her*

[8] (1935) 2 KB 113.
[9] (1967) 65 DLR (2d) 112.,
[10] (1908) 2 KB 89.
[11] Our emphasis.
[12] (1909) 1 Ch 267.

father and next friend).[13] The respondent in that case, through her father, entered into an agreement with the appellant to the effect that once the latter had purchased Falcon Air Ltd., the parties would hold shares in the company in the ratio of 60% for the respondent and 40% for the appellant. The respondent paid a sum of K110,000 to the appellant in consideration of receiving shares amounting to 60% of the equity.

The High Court upheld the respondent's claims for a declaration that the sum of K110,000 was for the purchase of shares in Falcon Air Ltd., and a declaration that the plaintiff was a shareholder, and for an account of all the property and money of the company. In his appeal the appellant argued that since the litigation had been between individuals, the court had no jurisdiction to bind the company to implement any decision passed as to the entitlement of the respondent. Further, that the proper formalities had not been complied with and that properly constituted Board of Directors (comprising the appellant and another) had never passed any resolutions on the question of the plaintiff's shareholding.

The court held shareholders enjoy, as a matter of right, overriding authority over the company's affairs. Where all the shareholders happen to be present at a meeting where an intra vires decision is passed with the unanimous concurrence of all of them, then even if the meeting was defective a director's meeting, the business transacted is valid as a member's decision (In *Re Express Engineering Works, Ltd.* followed).

The same point was stressed by the Supreme Court in *John Paul Mwila Kasengele and Others v Zambia National Commercial Bank*[14] where once again the court held that shareholders enjoy overriding authority over a company's affairs. The case involved a claim by employees that they be paid terminal benefits in accordance with the shareholders directive dated 28th March 1995. The appellants were employed by the respondent; a subsidiary of ZIMCO and wholly owned by government, the Minister of Finance being the sole shareholder.

The appellants were retired on various dates but between 18th March 1995, and 30th November 1996. On 28th March 1995, the then Minister of Finance wrote to the then Director-General with a copy to the President of the Republic of Zambia, that at its 87th Meeting of ZIMCO Board of Directors held at State House on August 26th, 1994, it was decided that the allowances be merged with salaries and that the decision be implemented without further delay. Upon their retirement the appellants were paid terminal benefits not based on the Ministers directive but on ZIMCO conditions of service then applicable. The appellants then filed a complaint in the court below which was unsuccessful.

On appeal to the Supreme Court, Muzyamba JS held that

> shareholders enjoy as a matter of right overriding authority over company affairs, even over the wishes of the Board of Directors and Managers…directors and managers must dance to the shareholder's tune.

The reasoning in the *Van Boxtel* and *Kasengele* cases was followed in two subsequent Supreme Court judgments of *Bank of Zambia v. Chibote Meat Corporation Limited*,[15] and *Zambia Consolidated Copper Mines Limited v. Richard Kangwa and Others*[16] which both held that

[13] (1987) Z.R. 63 (S.C.).
[14] SCZ Judgment No. 11 of 2000.
[15] SCZ Judgment No. 14 of 1999.
[16] (2000) Z.R. 109.

because shareholders are beneficial owners of a company, they have and enjoy overriding authority over the affairs of the company and can override the wishes or decisions of directors of the company.

Notwithstanding, these earlier Zambian decisions that took the view that shareholders could override the directors of a company, the Supreme Court in *Edgar Hamuwele (appealing in his capacity as joint liquidator of Lima Bank (in liquidation) and Christopher Mulenga (appealing in his capacity as joint liquidator of Lima Bank (in liquidation) v. Ngenda Sipalo and Brenda Sipalo*[17] sought to provide clarity on the power to manage the company's affairs. In that case the Supreme Court held that the board of directors govern the affairs of the company.

In the subsequent case of *Ruharo Limited v. Jan Willem Kloppers*,[18] the Supreme Court stated (albeit obiter) that: -

> Firstly, we must start our discourse by rejecting the appellant's assertion which seems to suggest that shareholders have overriding authority over company affairs to the extent of usurping the power which by statute, is vested in directors.

The above statement was an attempt to move by the Supreme Court away from the court previous decisions by asserting that shareholders cannot override management decisions taken by the directors of the company. The position of the Supreme Court in this case, without explicitly overruling the *Van Boxtel* and *Kasengele* line of cases sought to bring Zambian law with regards to management in line with the position in *John Shaw and Sons (Salford) Limited v. Shaw.*[19]

What can be seen from the above is that there is a clear disconnect between the common law and older case law and the Zambian decisions. However, with the enactment of section 86, the position is much clearer.

The common law concluded that the predecessors to section 86 conferred exclusive authority on directors. This entailed activist shareholders, unless they were also directors, had no actual authority to act for the company in relation to the outside world on most matters. If they purported to do so without the consent of the directors, prima facie their actions were nullities in law as far as the company was concerned.

It did not matter that the usurping shareholders were majority shareholders possessing enough voting power to enable them to call a meeting and remove the existing directors. Nor, at least unless they did so by special resolution, did it matter that the majority shareholders did go to the effort of calling a shareholders' meeting to resolve upon the business item in question.

The resulting resolution bound neither the directors nor the company. Indeed, the directors and the chairperson of a shareholders' meeting could decline to allow a management resolution to be put to the company in general meeting. If however, shareholders duly notified their desire to exercise one or more management decisions by way of a proposed special resolution changing the company's constitution, the directors would have had to allow that motion to proceed to a meeting.

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[17] SCZ Judgment No. 4 of 2010.
[18] SCZ Appeal No. 188/2016.
[19] (1935) 2 KB 113.

All this, it is suggested, remains true under s86. But this is not to say that individual shareholders who purport to usurp the functions of directors may not become liable to outsiders for doing so, for instance, in an action for breach of warranty of authority. They may also become liable to the company for any loss that ensues from their unauthorised conduct, perhaps in tort, or because of the application of the de facto director provision, discussed in the next chapter. The fact remains that they have no actual authority, or right, to act for the company in the management of its business.

Against the above background, we can now scrutinise the reasoning of the Court of Appeal. The majority of the Court of Appeal also held that:

> The guiding principle is that neither directors nor shareholders can interfere in each other's duties assigned by articles of association and the statute. Outside that, the shareholders take pre-eminence in determining the affairs of the Company through a general meeting. In our jurisdiction, the Supreme Court of Zambia has had occasion to pronounce itself on the powers of shareholders in the affairs of a Company in a number of cases. It would seem to us that a jurisprudence has been carved that preponderates decisions of shareholders over those of directors where such decisions are not in violation of articles of association and the governing statute.

According to the above statement, the Court of Appeal confirmed that the shareholders and directors cannot and should not interfere with powers and duties assigned to them by virtue of the articles of association and the legislation. This position is correct. In *Embassy Supermarket v. Union Bank (in liquidation),*[20] the Supreme Court in a judgment delivered by Mushabati JS held that: -

> We entirely agree that where a statute places a duty on an individual or officer no other person shall perform that duty unless it is so provided for under the same law.

The above confirms that only an individual who has been given a duty in terms of a piece of legislation can carry out that function.

However, it is the second part of the Court of Appeal's reasoning that is problematic. The Court of Appeal guided that *"Outside that, the shareholders take pre-eminence in determining the affairs of the Company through a general meeting***".** With all due respect this position is no accurate considering the provisions of the Companies Act which was enacted in 2017 and applied to the circumstances of the case before the Court of Appeal.

The starting point is section 86 of the Companies Act. This prima facie confers the powers of management of the company's business and affairs on directors. We have noted already that when directors exercise their powers, they are ordinarily required to act collectively, through the board. This is clear from section 86(1), and it was the default position at common law as outlined above. The starting point is section 88 and 89 of the Companies Act. This prima facie confers the powers of management of the company's business and affairs on directors. We have noted already that when directors exercise their powers, they are ordinarily required to act collectively, through the board. This is clear from s 128(1) and it was the default position at common law.

[20] SCZ Appeal No. 58/2006.

Section 86 of the Act reads as follows:-

> (1) Subject to this Act, the business of a company shall be managed by, or under the direction or supervision of, a board of directors who may—
>
> (a) pay all expenses incurred in promoting and forming the company; and
>
> (b) exercise all such powers of the company as are not, by this Act or the articles, required to be exercised by the members.
>
> (2) Without limiting the generality of subsection (1), and subject to the articles, the board of directors may exercise the powers of the company to—
>
> (a) borrow money;
>
> (b) charge any property or business of the company, including any of its uncalled capital; and
>
> (c) issue debentures or give any other security for a debt, liability or obligation of the company or of any other person.
>
> (3) The board of directors may, by power of attorney, appoint a person to be the attorney of the company for such purposes, with the powers, authorities and discretions that are vested in or exercisable by the board of directors, for such periods and subject to such conditions as the board of directors considers appropriate.
>
> (4) A power of attorney, made in accordance with subsection (3), may contain provisions for the protection and convenience of persons dealing with the attorney, as the board considers necessary, including an authorisation to the attorney to delegate all or any of the powers, authorities and discretions vested in that attorney.
>
> (5) All cheques, promissory notes, bankers drafts, bills of exchange and other negotiable instruments, including receipts for money paid to the company, shall be signed, drawn, accepted, endorsed or otherwise executed by two directors or as the board may determine.

Section 86(1) of the Companies Act provides that the business of a company shall be managed by, or under the direction or supervision of, a board of directors who may pay all expenses incurred in promoting and forming the company and exercise all such powers of the company as are not, by this Act or the articles, required to be exercised by the members.

Section 86(1) of the Act essentially provides that nobody else shall exercise the management of the company apart from the directors of the company. This provision should be viewed together with the Supreme court decision of *Embassy Supermarket v. Union Bank (in liquidation)*[21] where it held that where a statute places a duty on an individual or officer, no other person shall perform that duty. Therefore, only the directors are entitled to manage the affairs of the company as the statute explicitly places this duty on them.

Section 131 of the Companies Act provides that: -

> (1) The shareholders of a company shall, exercise the powers reserved to shareholders as specified in this Act or the articles—

[21] SCZ Appeal No. 58/2006.

(a) at a meeting of the shareholders; or

(b) in lieu of a meeting, by a resolution made in accordance with section 77.

(2) A power reserved to shareholders shall be exercised by ordinary resolution, unless the articles or this Act specify otherwise.

By virtue of section 131 of the Companies Act, the shareholders can only exercise powers reserved for them in the Act or articles. This provision read together with section 86 makes it clear that the shareholders cannot exercise management functions of the affairs of the company, as this is the duty of the directors of the company – and may only exercise the residual powers reserved for them in terms of the statute or the company's articles of association.

A reading of section 86(1) and 131 of the Act confirms the case of *Howard Smith Limited v. Ampol Petroleum Limited*,[22] where the court held as follows:

> …it is established that directors, within their management powers may take decisions against the wishes of the majority of shareholders, and indeed that the majority of shareholders cannot control them in exercise of these powers while they remain in office.

Therefore, directors have the powers of the management of the company whilst the shareholders only have the power to consent to or take decisions on matters not reserved for management such as the power to appoint directors. This is the case, even if the shareholders do not agree with the manner in which the directors are managing the company. Further, in *Grundt v. Great Boulder Proprietary Mines Limited*,[23] Cohen LJ stated that

> There is nothing unusual in the shareholders not being allowed to interfere in matters which have been deliberately placed under the control of directors.

Sections 86 and 131 of the Companies Act reinforce the holding from *Grundt* above, in essence overruling the quartet of Zambian Supreme Court cases referred to above by providing that only the directors can exercise the management of the business of the company and the shareholders must only exercise the powers *reserved* for them. In *Ashburton Oil NL v. Alpha Minerals NL*,[24] it was stated that:-

Directors who are minded doing something which is in their honest view is for the benefit of the company are not restrained because a majority shareholder of shareholders holding a majority of shares in the company do not want the directors so to act.

The only powers that shareholders have is to exercise the powers which the directors have limited powers to exercise.
An important qualification to the authority of the directors to run and manage the company's business is found in section 87 of the Act. Section 87 of the Companies Act provides that the board of directors shall not perform certain functions without the approval of the shareholders by an ordinary resolution. The powers that need shareholder approval are: -

- sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking or assets of the company;

[22] (1974) AC 821

[23] (1948) Ch 145.

[24] (1971) 123 CLR 614.

- issue any new or unissued shares in the company;
- create or grant any rights or options entitling the holders to acquire shares of any class in the company; or
- enter into a transaction that has or is likely to have the effect of the company acquiring rights or interests or incurring obligations or liabilities, including contingent liabilities, the value of which is the value of the company's assets before the transaction.
-

The powers in section 87 can be referred to the shareholder's residual powers. They seek to give the shareholders a say in major transactions given that may significantly impact the business and/or direction of the company. As such, the law confers on the shareholders, the residuary power to consent to these before they are carried out.

The idea behind section 87 of the Act is to inject some grassroots participation by shareholders into the running of company, particularly where the directors are proposing to take the company in a new direction by proposing a significant transaction. However, the intention behind the provision was that the shareholders should only consent to major transactions as opposed to regular day-to-day issues that could easily be handled by the directors.

As such the first thing to note about section 87 is that it does not, in fact, transfer the authority to initiate and enter into the major transactions identified from the directors to the shareholders. Rather, the provision creates a precondition to the exercise by the directors of their authority that they obtain the consent of the shareholders.

For the avoidance of any doubt, the mere fact that a transaction is a major transaction identified by section 87 of the Companies Act does not remove the board of director's apparent authority to enter into it. Therefore, the decision to initiate and complete a major transaction remains one for the directors, who must only complete the process of the transactions identified only once they have had shareholder approval.

It is often difficult to tell whether a proposed transaction falls within section 87 (2) (d). Caution suggests that if there is any doubt, a special resolution should be obtained. Otherwise, valuation evidence will often be needed to determine the value of the company's assets, upon which section 87 (2) (d) depends. It has been held that mere book values will not ordinarily be appropriate.

The decision of the Court of Appeal should have adopted the approach of the analysis rendered above. The decisions of the earlier Supreme Court of Zambia were not on par with principles of corporate governance. In any case, the enactment of sections 86(1) and 131 of the Companies are a welcome development in clarifying that subject only to the provisions of the articles and the Act, the company in general meeting may not, therefore, override the directors' discretion or direction the board on how to act, and can only exercise powers reserved for them because the transaction is not equal to or more than the value of the assets.

Based on the above, the Court of Appeal's approach of maintaining adherence the Supreme Court decisions was a gross misdirection given the introduction of section 86 and 131 of the Companies Act.

Best interests of the company

The High Court or the court below in this matter held that: -

> With respect to the Plaintiffs' argument that Victor Makuza acted against the interests of the shareholders to whom he reported, it is clear from Section 105(c) and 106 of the Companies Act No. 10 of 2017 that a director acts in the best interests of the Company and not the shareholders, therefore, the assumption is that Victor Makuza acted in the best interests of UFZ when he stopped repayments of the loans from UFZ Sales.

As it related to the argument that Mr. Victor Makuza acted against the shareholders of the company, the High Court was of the view that a director is mandated to act in the best interests of the company and not the shareholders.

Section 105 (c) of the Companies Act provides that: -

> Subject to this Act, a director shall—
> (a) ….
> (b) ….
> (c) exercise that director's power—
> (i) act in good faith and in the best interests of the company;

It is a well-established rule of common law that the directors of a company have a fiduciary duty to exercise their powers in good faith and in the best interests of the company. Good faith depends largely on honesty which is subjective. A breach of this duty thereby requires subjective awareness of wrongdoing.

In *Hogg v. Cramphorn,*[25] the court stated that it was not for the courts to review the merits of a decision that the directors arrived at in honesty. The directors of a company have more time, knowledge, and expertise at their disposal to evaluate the best interests of the company than a judge. Therefore, the courts will not presume to act as a kind of supervisory board over directors' decisions that are honestly arrived at within the powers of their management.

The court in *Re Smith & Fawcett Limited*[26] laid down the legal principle that the directors are bound to exercise their powers conferred upon them bona fide in what they consider, not what another person or court may consider, is in the best interests of the company. A director's duty is thus to act in what he or she, subjectively, in good faith honestly considered to be in the best interests of the company.

Although the test is subjective, there are limits. The absence of a reasonable ground for believing that the director is acting in the interests of the company may be the basis for finding lack of good faith. In *Extrasure Travel Insurances Limited v. Scattergood,*[27] the court emphasised that there must be reasonable grounds for the belief of the directors that there were acting in the interests of the company. In other words, there must be reasonable grounds for the director's belief that they were acting in the best interests of the company.

The recent formulation of the limits of the subjective test was formulated in *Charterbridge Corporation Ltd v. Lloyd's Bank*[28] where it was stated that the test is whether an intelligent and

[25] (1967) Ch 254.
[26] (1942) Ch 304.
[27] (2003) 1 BCLC 598 (ChD).
[28] (1970) Ch 62.

honest person in the position of the director could in the whole of the circumstances have reasonably believed that he or she was acting in the best interests of the company.

Notwithstanding the above, the question that arises is what it means to act in the 'best interests of the company'. According to the majority of the Court of Appeal, Siavwapa held that: -

> the corollary of Gower's legal proposition is that interests of the Company should translate into benefits for both the Company and the shareholders. It is therefore, contrary to the core of the theory of corporate governance to hold that a director can act to the detriment of shareholders in the name of acting in the best interest of the Company.

As a general rule directors owe fiduciary duties to the company and the collective body of shareholders.[29] In *Peskin v. Anderson*,[30] the court per Mummery LJ echoing and confirming the *Percival v Wright*[31] judgment held that:-

> the directors of a company are not trustees for individual shareholders and may purchase their shares without disclosing pending negotiations for the sale of the company's undertaking.

The court in *Peskin v. Anderson* held that directors only owe fiduciary duties to individual shareholders where there is a special, factual relationship between the directors and shareholders in the case.

By parity of reasoning, and based on the principles that the company is a separate legal entity from its shareholders, the majority of the Court of Appeal was not on firm ground when it seemed to suggest that the best interest of the company also means the best interests of the shareholders. To repeat and for the avoidance of any doubt, the Court said:-

> It is therefore, contrary to the core of the theory of corporate governance to hold that a director can act to the detriment of shareholders in the name of acting in the best interest of the Company.

The above suggests that if a decision inconveniences or disadvantages shareholders, but is in the best interests of the company, such a position is contrary to the theory of corporate governance. Such a viewpoint is untenable. If directors are acting and carrying out their functions, they do so for the benefit of the company, including the shareholders.

The benefit is to the company is supreme, and it is the company, whom the directors owe duties. It is the role of the directors to ensure that they maximise the revenue and profits of the company, as well as ensure its long-term viability. Whilst these may align with the objectives of the shareholders, the primary responsibility is to the company, not the shareholders who merely have an interest in a return on their investment.

The Court of Appeal seemed to suggest that a decision contrary to the shareholders' interests in their individual capacities cannot be said to be in the best interests of the company. This viewpoint is no correct and should not be followed given the guidance that directors act in a

[29] *Greenhalgh v. Arderne Cinemas Ltd* (1951) Ch 286.
[30] (2000) EWCA Civ 326
[31] (1902) 2 Ch 421.

fiduciary position to the company and not individual shareholders, unless there is a special, factual relationship between the shareholders and directors. The Supreme Court of Zambia in *Mayank Kumar Patel v. Kantilal Pragji Ranchhod and 3 Others*.[32] In the *Mayank Patel* case, per Chitengi JS held that:

> It is clear to us that an individual shareholder's right to bring an action on his own behalf is limited…an individual shareholder or minority shareholder can bring action on their own behalf where a special factual relationship exists between them and the company directors. Otherwise an action by an individual shareholder should be brought on behalf of the company or derivatively.

In the absence of this special relationship, the directors owe duties to the company only and their primary responsibility is to ensure they do what they can in the best interests, of the company and not necessarily the shareholders. This conflation on whom the directors act for should be avoided, notwithstanding the fact that the shareholders are often the beneficial owners of the company, who appoint the directors.

Under the common law, the case of *Re D'Jan of London Limited*[33] expressed concerns that a director who was found to be negligent could ever be deemed to have acted reasonably. They held this because they believed that negligence usually demonstrates a failure to exercise reasonable care and skill. This has since been altered by the introduction of the business judgment rule.

The "business judgement rule" is a concept derived from United States company law, although the phrase "business judgement" is common parlance and, not surprisingly, was employed in Commonwealth case law some distance back. Hence, in *Barcelo v Electrolytic Zinc Co of Australasia Ltd* Starke J stated:

> [t]he matter is remitted by law to the business judgment of the directors of the company, exercised honestly and reasonably in the interests of the company and its shareholders.

The business judgement rule is applied both prospectively and retrospectively. So, directors will not generally be liable for any loss suffered by the company from their decisions if the conditions attached to the rule are complied with. It was created as a way of safeguarding directors who made decisions in good faith and in the best interests of the company. The essence of the rule is that, provided the conditions have been complied with, good faith decision making by directors will not lightly be found negligent just because, with hindsight, different decisions ought to have been made.

Section 121 of the Companies Act now embodies the business judgment rule and provides that:-

> A decision made by an officer of a company shall, subject to the requirements as to disclosure, be considered valid if the—
>
> (a) decision is made in good faith for a proper purpose;
> (b) officer does not have a personal interest in the decision;
> (c) company is appropriately informed of the subject matter of the decision; and

[32] SCZ Appeal No. 104 of 2007.
[33] (1994) 1 BCLC 561 (Ch).

(d) officer reasonably believes that the decision is in the best interests of the company.

Therefore, in terms of section 121 of the Companies Act, a decision made by an officer of the company shall, subject to the disclosure of the company be considered to be valid if the decision was made in good faith for a proper purpose, the director has not personal interest in the decision, the company is appropriately informed of the subject matter and the director reasonable believes the decision was in the best interests of the company. All these requirements must be met before a decision in breach of the officer's duties considered valid by the company. The use of the word 'shall' indicates that if all the requirements in section 121 are met, a decision of an officer should be considered as valid.
Directors are employed to take risks, often under severe time pressures – some risks pay off and some risks do not. The directors' key skill is one of balancing the risk and time factors, recognising that their company's success and failure will depend on their not being unduly cautious as well as avoiding foolhardiness.

Therefore, the rationale for section 121 is to recognise the need to promote and encourage directors to take reasonable risks and be innovative in how they conduct themselves and when they make decisions. The fear of being held liable would fetter the director's ability to take risks and this new provision will encourage directors to perform their functions with more freedom to promote the interests of the company.

In my view section 121 recognises the principle established in *Hogg v. Cramphorn*[34] which provides that where directors act honestly and believe their actions were in the best interests of the company but exercised their power for a purpose other than for what it was given, the company through its shareholders could ratify the decision. In that case, the court held that a share allotment was invalid because even though the directors were acting in good faith, they exercised their power for an ulterior motive.

Section 122 of the Companies Act reads as follows:-

> Where a company establishes that a decision made by an officer is—
>
> (a) not valid, the officer shall be held personally liable for any obligation or liability that arises as a result of that decision; or
>
> (b) valid, the officer shall be indemnified for that decision

Where a decision is not valid, i.e., does not meet the criteria under section 121, the officer will be held personally liable. If the decision is considered valid by the Company, section 122(2) *(b)* of the Companies Act provides that the officer of the company shall be indemnified for that decision. In *Re Lee Behrens & Co Limited*,[35] the court held that an agreement by the company to pay a pension to a widow of a former Managing director was invalid because it was neither incidental to the operations of the business nor for the benefit of the company.

In *Fresh Mint and 3 Others v. Kawambwa Tea Company*,[36] the Supreme court held that the actions of the director in obtaining an unauthorised loan could not be validated because it did not benefit the company in any way. The substratum of these two cases is even if a director

[34] (1966) All E.R. 420
[35] (1932) 2 Ch 46.
[36] SCZ Judgment No. 33 of 2008.

breached his fiduciary duties or acted beyond his powers, he could be indemnified if the company finds it valid because it was in the best interests of the company, for a proper purpose or another legitimate reason such as those provided in section 121 of the Companies Act.

However, in these two cases, none of the criteria that has been provided for in section 121 of the Act were met and the court was justified in finding that the director's actions were invalid. Further, the company's shareholders are permitted to sue any director for the breach of his fiduciary duties. Further, sections 138 and 335 of the Companies Act provide that a shareholder may commence an action against the company or a director for a breach of a duty owed by the company or director to the shareholder or an illegal act done by the company or a director. This is an exception to the rule in *Foss v. Harbottle*[37] which held that the company having separate legal personality should sue in its own name. Shareholders are permitted to commence this action especially as was the case in *Cooks v. Deeks* where they allege fraud or serious negligence on the party of the directors.

A further criticism of the approach of the majority of the Court of Appeal is failing to recognise the existence of the business judgment rule under Zambian law. As discussed earlier, the issue of corporate governance doesn't arise in the circumstances because the matter was purely contractual in nature. However, the misapprehension as to the role of Mr. Victor Makuza in the meeting raises the question as to whether a director can decide contrary to the wishes of the shareholders, and does he have recourse if he genuinely believes a decision is in the best interests of the company. This notwithstanding, even in the case that it was found Mr. Victor Makuza acted negligently or without due regard to the company's interests, he would have been protected by section 121 and 122 (b) of the Companies Act. This further underscores the viewpoint that the decision of the majority of the Court of Appeal was not correct.

Conclusion

The decision in this matter is important because it once again brings to the fore issues of corporate governance in Zambia. This article has opined that the Court of Appeal should not have applied the principles from *Van Boxtel, Kasengele, Chibote Meat* and *Kangwa* when the Companies Act has since been amended to provide a clear delineation of power between shareholders and directors.

As discussed, although the shareholders are not permitted to overrule directors and only exercise powers reserved for them, this article has highlighted that shareholders do have the following recourse: -

1. The shareholders do however have the power to determine the scope of powers of management of the directors. In *Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cuninghame*,[38] it was stated that the relationship between the directors and shareholders is based on the powers conferred by the shareholders in the articles of association.
2. In addition, the shareholders can also do so by passing a special resolution or deciding by unanimous assent deciding on the matters that the shareholders can carry out, provided they are not contrary to the statute.

[37] (1843) 2 Hare 461.
[38] (1906) 2 Ch 34.

3. Lastly, the shareholders are at liberty to remove directors who do not manage the company in the manner they deem fit, subject to giving them an opportunity to be heard as required by section 99 of the Companies Act.

Notwithstanding the above, it should be emphasised that the majority of the Court of Appeal focused on the wrong issue. Instead of dealing with the corporate governance issue, the focus should have been on the wording and interpretation of Clause 13.1 which provided for prior written consent to be given before the transfer of liability from the 1st and 2nd Appellants to a third party. For these reasons, Justice Sharpe-Phiri JA's approach is certainly preferable, and provided the correct outcome.

This article has opined that although the issues of corporate governance were not relevant, it presents a prime opportunity to the Supreme Court to clarify the issue, if indeed this matter proceeds to the apex court.