THE BUSINESS JUDGEMENT RULE IN TERMS OF SECTION 54 OF THE COMPANIES AND OTHER BUSINESS ENTITIES ACT [CHAPTER 24:31: ITS IMPLICATIONS ON DIRECTOR LIABILITY

by

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DEDICATION

I dedicate my dissertation work to my daughter Makanaka, if I can do this you can do more, to my wife for the support and to my many friends. I wish to express my sincere gratitude to my loving parents whose philosophy of diligence has shaped my schooling and working life.

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ABSTRACT

Due to the high rate of corporate failure Zimbabwe is now characterized by low foreign direct investment, low capacity utilization and high reliance on imports which has created a huge trade deficit further driving the country into economic malaise. There have been many academic essays and thesis exploring the economic, political and social causes of the high rate of corporate failure and its harsh adverse effects on the broader community in Zimbabwe. Corporate law has undergone major transformation at the international level. This has largely been because of the major corporate collapses that unraveled world-wide. Many countries have been left with little options but to also consider whether directors of corporations were observing their requisite fiduciary duties. These duties must be observed with the standard of care and diligence that investors legitimately expect of directors in an ever-modernizing commercial world.

Amongst several initiatives to improve the investment climate and to keep pace with dynamics in the corporate world, Zimbabwe has responded to the global phenomenon and initiated a process to reform its company laws. This was partly motivated by the need to ensure high standards of corporate governance and to harmonize its laws with best practice internationally. To this end, the Companies and Other business Entities Act [Chapter 24:31] was enacted to replace the Companies Act [Chapter 24:03]. This thesis seeks to critically analyze the Business Judgement Rule (BJR) which the new Act introduced in terms of section 54 in the light of international best practices.

Expressed in its simplest form, the general thrust of the rule is that it seeks to improve standards of directors' conduct and enhance corporate governance without unnecessarily trammeling innovation and business growth in the country. The rule has wide international recognition, but its implementation varies from one jurisdiction to the other. The variances are largely as a result of peculiar and unique characteristics of each jurisdiction.

As Zimbabwe adopts the new Act, it remains to be seen how the rule will be applied in our jurisdiction. Like any other legal principle or doctrine, it is the historical context of a particular jurisdiction that inform its jurisprudence and how it develops. From a comparative assessment done on selected jurisdictions, the principle in the rule transcends in a similar manner but each jurisdiction tends to differ in the application. The thesis seeks analyze the adoption of the business judgement rule as a core feature in the commercial law realm of Zimbabwe. What is the most likely course that is to be adopted especially based on how the rule has been applied in similar jurisdictions? This present work further seeks to shape the interpretation and application of the business judgement rule with a focus on derivative actions.

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CHAPTER 1

1.1 INTRODUCTION TO THE STUDY

For a long time in the history of corporate law, issues relating to the duties and liabilities of directors and officers of companies have been quite topical. Significant opinions and positions have been postulated through court judgements and academic papers. Corporate scandals have been rife with the notorious ENRON, Parmalat of America and most recently the Steinhoff Group in South Africa. Resultantly, there is persistent public interest in good corporate governance anchored on diligent and reasonable management. Over time, the occasional seasons of global financial distress and crisis have shown that directors and managers take enormous risks in order to gain financial advantages. Many at times it has become evident, that the system of risk overview and other precautionary measures failed to prevent the occurred damages. Although there were numerous red flags, directors were not alarmed and carried on with their risky business all in the hope of getting the greatest possible financial returns for the company.

The need to institute effective corporate governance system within organizations has been a central issue throughout the development of corporate law[1]. Such efforts have been either through the promotion of best practice or deliberate legislative interventions. Over time, common law doctrines and concepts around this field have equally evolved. Zimbabwe for the past 20 years has been in economic distress and directors are making risky decisions daily all in the hope of sustaining companies. Such an economic environment has once again brought the laws of director's liability and corporate governance into the public interest. These directors may end up assuming personal liability for some of these decisions. In the light of these experiences, the Business Judgment Rule becomes an important centre of attention within this discussion.

Amongst other possibilities, the Business Judgment Rules shields directors from the risk of personal liability. It becomes critical to assess whether the legal system and courts in Zimbabwe are properly cognizant of the historical, philosophical and policy considerations around the

[1]R Naidoo Corporate Governance: An Essential Guide for South African Companies 2nd Ed. (2009) at 2

adoption of this rule which has been incorporated into our statutes. Equally there is need to contribute to the process of shaping the application of this rule and how it affects the law on derivative actions.

1.2 Background to the Study

Corporate governance has become an important factor in managing organizations in the current complex environment. It is a trite principle and notorious fact that a company can only function through human actors. Corporate officer's and director's act are the central hub in relation to the conduct of a company as they make decisions and direct the company in a particular course[2]. Directors are accordingly at the core of many business scandals and failures in recent years with which the public has become so engrossed.

Zimbabwe recently promulgated a new Companies and Other Business Entities Act [Chapter 24:31] to replace the Companies Act [Chapter 24:03] which has been in existence since 1951. Admittedly, whilst the Act has undergone a number of amendments over time, the need for a new overhauled Act was long overdue. There is always a need to improve corporate law and practice to run with what is happening globally. The thrust to establish and consolidate functional and effective corporate governance systems among other things appears to be a major objective of the new Companies and Other business Entities Act [Chapter 24:31]. The new Act which became effective on the 13th February 2020 seeks to overhaul the corporate law of Zimbabwe in several ways.

The present research is being done during the infancy of the Act and before any key legal dispute or case is brought before the courts in respect of any matter arising from the new Act. As a result, the thesis will inevitably not be fully conclusive in as far as defining the law on subject matter under study. Nonetheless, it is hoped that the opinions and positions to be postulated herein will provide a firm basis in the interpretation and application of the concepts when the time comes. It will also provide a firm basis for future research around the area.

[2] The term 'directors' will be used to refer generally to corporate officers and directors throughout this dissertation to refer generally to corporate officers and directors of a company.

Zimbabwe as a country has been in a state of financial crisis for at least the past twenty (20) years. This state of financial crisis has taken a number of forms and differs in its character over the same period, but the overall state of the economy remains largely to be in a crisis regardless of the variations in respect of each particular periods. The general outlook shows that this is likely to remain so for some time going forward. That being the case, there is a need for an enquiry as to what extent this will impact the application of the law especially under such prevailing economic conditions.

In times of financial crisis, companies face a number of challenges which include but not limited to difficulties in securing and managing debt financing facilities, declining asset values and weakening demand due to rising unemployment, contractions in business spending and generally poor consumer and business sentiment. These problems have arisen in circumstances where many large companies and investment funds are being forced to sell assets into falling markets in order to pay down debt or simply to generate enough funds to continue trading. There is little doubt that the financial crisis has made the job a running a business, large or small, more difficult and more uncertain[3].

For any corporate executive, the key to business planning is a reasonable degree of certainty regarding the future operations of the business and to an extent, the broader operating market or environment conditions. The existence of a financial crisis regardless of its magnitude diminishes the certainty element and if well pronounced it throws certainty out through the window[4]. Globally, In the midst of a financial crisis there has been doubt not simply about the ability of businesses to settle their existing obligations to financial institutions such as banks, but also whether the bank itself would still be in existence when the loan becomes due or throughout its tenure[5].

On one view, managerial skill is often measured by one's ability to navigate through uncertain business conditions and to adjust to changing circumstances so as to maintain a competitive

[3] M Legg and D Jordon, 'The Australian Business Judgment Rule After ASIC V Rich: Balancing Director Authority and Accountability' (2014) 34 ALR 403

[4] J Mayanja 'Promoting Enhanced Enforcement of Directors' Fiduciary Obligations: The Promise of Public Law Sanctions' (2007) Australian Journal of Corporate Law 20(2) 157.

[5] J J du Plessis, 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared — Part 1' (2011) 32

advantage. Success and failure in business are opposite sides of a very fine line walked by all business executives. The potential risks of business failure are tempered somewhat in capitalist societies by the protection of limited liability through incorporation.

The innovation and competitive advantages obtained through entrepreneurial risk taking are facilitated by the certainty, at least for major corporations. This is primarily driven by the limited liability that is accorded to the Directors and Managers of such corporates. This may relatively differ with small to medium enterprises wherein banks may ask the Directors or shareholder to provide personal securities for any facilities extended.

The Business Judgement Rule has its origins in the US common law and primarily applies to the director's duty of care and skill. It is a judicial mechanism that is resorted to in an attempt to limit the scope of personal liability for corporate directors and officers. The rule entails a rebuttable presumption that a director or manager, when making a business decision, has proceeded on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. In its effect, the rule should form a safe harbor for rational and informed managerial actions. It must provide an escape route for a director from personal liability under a derivative action.

Derivative actions by their nature are a statutory exception to the principle that corporate liabilities are debts owed by the company as a separate legal person and not by the proprietors of the company itself who enjoy limited liability. The directors and officers of the company are not, in the ordinary course of business, liable for the corporate debts because they are either acting as the company when they sign contracts or because they are acting as the agent of the company and the company is bound as principal[6]. If personal liability were imposed on company directors and officers for all corporate debts it would create a disincentive to take risks with the company's business[7]. Adopting

[6] A. King, 'The Squeeze on Insolvency', BRW, 16 July 2009, p 50; John Martin, 'GM a lesson in failings of local insolvency laws', The Australian Financial Review, 10 June 2009, p 63; James Eyers, 'Directors need more protection', The Australian Financial Review, 13 May 2009, p 12

[7] J. Harris," Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?" in the article the author argues that Insolvent trading liability needs to have a sufficient policy basis to justify the possibility of limiting business success because of the threat of personal liability. In the author's view, there is little doubt that insolvent trading liability is sufficiently justified. It is a necessary evil that the law needs to approach cautiously in the interest of ensuring continued business operations especially in crisis situations.

a contrary position would entail that only those debts that were guaranteed of being paid only would be likely to be incurred. Such a conservative approach would stifle entrepreneurial risk-taking and limit the economic benefits and advantages that flow therefrom.

1.3 Statement of The Problem

The Business Judgment Rule has been in operation in the US firstly and in many other jurisdictions for many years. There has also been numerous court decisions and academic postulations on the same subject. Nevertheless, there is no common definition and application of the Business Judgment Rule across the various jurisdictions where it is recognized and applied. Settling for a common universal definition is quite challenging because every jurisdiction has its unique challenges and therefore its own approach.

The Companies and Other Business Entities Act [Chapter 24:31], has introduced the Business Judgment Rule into our corporate law. However, this recently implemented concept has not yet been applied by the Zimbabwean courts. The need to fully understand the Business Judgment Rule, to examine its rudiments and to seek to detect the potential problems courts possibly may have to deal with cannot be over-emphasized. The intention of the codification is to craft a "safe harbor" for directors and to provide a shield against liability imputations[8]. It remains to be seen how the rule will be applied in Zimbabwe and the present work seeks to provide a guide and a preferred framework for the application of the rule.

1.4 Objectives of The Study

One of the key objectives of corporate law is that it seeks to strike and maintain balance the rights and obligations of shareholders and directors. Directors upon appointment act as trustees for the owner of the property, the shareholders. The law imposes personal liability on the directors for mistakes in managing the company as one measure to protect the shareholders from ineffective or false management. To counterbalance for this personal liability, the business judgment rule ought

[8] L Muswaka; 'Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis' (2013) International Journal of Humanities and Social Science, Volume 3 Number 7 at 89

to protect them from excessive and unjustified risk of personal liability with regard to business decision. To achieve this, the rule must be well understood and applied homogeneously. This thesis intends to offer additional knowledge about the rule and its concrete applications and shall seek to achieve the following objectives:

1. To trace the development and application of the Business Judgement Rule from selected jurisdictions that have influenced its adoption in Zimbabwean law;
2. Ascertain the relationship of the duty of care, skill and diligence, to the business judgement rule and how it affects derivative actions;
3. To provide a critical analysis of the adoption of the business judgement rule under section 54 of the Act in promoting high standards of corporate governance whilst also promoting innovation, investment and efficient management of companies in Zimbabwe;
4. To explore the possible framework that may best be adopted in the application of the rule within the Zimbabwe context.

1.5 Research Methodology and Parameters

1.5.1 Methodology of the study.

This dissertation has been done primarily through both the analytical and empirical method. The dissertation examined legal theories and concepts, academic writings as well as judicial pronouncements on the business judgement rule. Much reliance has been on library research through which there has been a review of legislation and the common law. Comparative study of international best practice will also be done, and nations will be selected for their comparative values. Particular attention has been placed on Canada, Australia and South Africa as they appear to have influenced most provisions in the Act over and above the wording of section 54.

1.5.2 Research Parameters.

The present research focused on establishing a brief history of the law that defines or shapes the business judgement rule and this has largely been through undertaking a comparative research approach with Canada, Australia and South Africa. The choice of these jurisdiction is simply discretionary based on the researcher's appreciation of the similarities to the new Act.

1.6 Justification of the study

The present work is of significance in the following ways:

1) *Researcher* – as a corporate law practitioner the study will improve the researcher's knowledge of the jurisprudence on the subject matter;
2) *University of Zimbabwe* – it will contribute to the body of academic knowledge on corporate law in general and on the business judgement rule in particular;
3) *Corporate Directors* – the study will assist them to understand the defenses available to them in the event of a challenge to any of their decisions.
4) *Courts in Zimbabwe* – this research will assist in the understanding and possibly influence the application of the rule;

CHAPTER 2

2.0. CONCEPTUAL FRAMEWORK OF THE BUSINESS JUDGMENT RULE, DERIVATIVE ACTIONS AND THE FIDUCIARY DUTIES

2.1 Chapter Introduction

The business judgment rule is inseparable from the duty of care and skill. The rule applies to the specific aspect of decision making under the duty of care. Understanding the duty of care is accordingly imperative for correctly understanding the business judgment rule[9]. The need for continuous reliance on good governance cannot be over-emphasized under the present work. In most cases, most derivative actions against Directors stems from abuse of or neglect of good tenets of governance. Ultimately, adherence to good governance is the starting point in as far as fiduciary duties are concerned.

Of relevance to this thesis is the South African Company Law for the 21st Century: Guidelines for Corporate Law Reform (2004)[10] commonly referred to as the 2004 DTI policy paper regarding directors' duties and standards of conduct. It is captured as a desire to provide for "a clear, facilitating, predictable and consistently enforced law" which provides a "protective and fertile ground for economic activity". The DTI paper had a substantial influence on the enactment of the South African Companies Act 2008 which in turn has also had significant influence in the drafting of Zimbabwe's Companies and Other Business Entities Act. This chapter will therefore also attempt to provide a link between corporate governance and the business judgement rule.

2.2 The Business Judgement Rule

Whilst the origins of the rule can be traced to the United States of America, comparisons shall be made particularly with Australia, Canada and South Africa. The business judgment rule is an important caveat to the corporate duty of care owed by officers and directors to their companies.

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[9] S Kennedy-Good & L Coetzee 'The Business Judgment Rule (Part 1)' (2006) Obiter 62 at 63

[10] Department of Trade and Industry, Government Gazette No. 26493, South African Company Law for the 21st Century: Guidelines for Corporate Law Reform (2004) [hereinafter Guidelines for Corporate Law Reform] available at http://www.info.gov.za/gazette.notices/2004/26493.pdf.

By its nature and legal construct, the duty of care requires directors and officers to act in as competent a manner as would reasonably prudent people in their positions[11]. Officers and directors must make decisions that they believe, in good faith, to be in the best interests of their companies and must make decisions after appropriate research and due diligence inquiries. This is the framework within which any business decision should or ought to be arrived at. The decisions must be the products of appropriate care and thought.

The most frequently quoted, if not the earliest, expression of this rule is to be found in an 1829 case, *Percy v Millaudon* where the court ruled that:

> *"...the occurrence of difficulties ... which offer only a choice of measures, the adoption of a course from which loss ensues cannot make the [director) responsible, if the error was one into which a prudent man might have fallen."*[12]

The court articulated the business judgment rule as follows:

> *"It is no doubt true that if the business to be transacted presupposes the exercise of a particular kind of knowledge, a person who would accept the office of mandatory, totally ignorant of the subject, could not excuse himself on the ground that he discharged his trust with fidelity and care.... But when the person who was appointed attorney-in-fact, has the qualifications necessary for the discharge of the ordinary duties of the trust imposed, we are of opinion that on the occurrence of difficulties, in the exercise of it, which offer only a choice of measures, the adoption of a course from which loss ensues cannot make the agent responsible, if the error was one into which a prudent man might have fallen."*

Officers and directors who fail to uphold their duties of care can be subject to shareholder lawsuits, including shareholder derivative actions, for any damages caused by these failures. These lawsuits, which can subject officers and directors to heavy monetary liability, are very powerful tools to penalize derelict directors. This is evident from high-profile shareholder derivative suits that have

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[11] L. Llewellyn, "Breaking Down the Business-Judgment Rule", American Bar Association Commercial & Business Litigation Section, (2013)

[12] "Percy v. Millaudon, 3 La. 568 (1832)

been brought against directors of many major corporations, including Apple, Citigroup, Walt Disney, and Enron, wherein shareholders have successfully challenged activities of boards of directors[13].

The business judgment rule is a standard of judicial review of corporate director and officer conduct. There is no generic definition of the "business judgment rule". It's inconsistent and uncertain approach across jurisdictions has led to its being called "the most enigmatic doctrine in corporate law."[14]

The rule protects officers and directors from liability where they have made decisions in good faith and using appropriate procedures, even if those decisions turn out to be poor or unwise. Corporate officials eligible for protection under the business judgment rule are not liable for breaching duties of care merely because they have made mistakes[15].

For starters, to be eligible for this protection, the director or company official must have met certain standards of conduct. The American Law Institute (ALI) language provides[16]:

> "(c) A director or officer who makes a business judgment in good faith fulfills the [duty of care] if the director or officer:
> (1) is not interested in the subject of his business judgment;
> (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
> (3) rationally believes that the business judgment is in the best interests of the corporation."

The business judgment rule is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken

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[13] A Scarlett, "A Better Approach for Balancing Authority and Accountability in Shareholder Derivative Litigation", 57 Kan. L. Rev. 39, (2008)
[14] D. Gordon Smith, "The Modern Business Judgment Rule", The CLS Blue Sky Blog, (2015)
[15] S.R. Cohn "Demise of the Director's Duty of Care: Judicial Avoidance of Standards and Sanctions through the Business Judgment Rule" (1983) 62 Texas Law Review 591.
[16] ALI Corp. Governance Project, Section 4.01 (c).

was in the best interests of the company. Assuming those conditions are met, corporate officials are not liable for adverse consequences of decisions that turn out to be inadvisable[17].

The legislature intervened to codify the law regarding director's duties and liabilities. In many respects the Companies and Other Business Entities Act has created a wider base of potential liability for directors, whilst simultaneously it has introduced the business judgment rule into Zimbabwean company law. The origins of the business judgment rule lies American common law and is a legal mechanism which limits director liability in cases where the directors are accused of contravening the duty of care and skill when making business decisions[18].

"Section 54 (4)[19] sets out the Business Judgment Rule in Zimbabwe:

> *(4) A person who makes a business judgment acting as stated in subsection (1), (2) and (3) fulfils the duty under this section with respect to that judgment if that person—*
>
> > *(a) does not have a personal interest as defined in section 56 ("Transactions involving conflict of interest") in the subject of the judgment; and*
> > *(b) is fully informed on the subject to the extent appropriate under the circumstances; and*
> > *(c) honestly believes when the judgment is made that it is in the best interests of the company or corporation."*

The rationale for the business judgment rule is simple. A successful business requires directors who can react quickly to changing market needs and technological developments; business is about taking risks, and directors must be able to take risks without fear of their conduct being judged, to their financial prejudice, by hindsight. If a director faced the possibility of a negligence action whenever he made an honest mistake, few competent persons would be willing to take on the office.

[17] *Aronson v. Lewis*, 473 A.2d 805, 1984 Del. LEXIS 305 (Del. Mar. 1, 1984)
[18] D Ahern 'Directors' Duties, dry ink and the accessibility agenda' (2012) 128 (January) Law Quarterly Review 114
[19] Companies and Other Business Entities Act, No 4 of 2019

Personal Liability of directors is an important aspect of corporate law in any country and reflects on the capacity of the companies to attract the best skills on their Boards. Generally people would not want to be directors of companies where their decisions would result in them being held personally liable. At the same there is need to protect the company, its shareholders and the creditors from fraudulent or reckless acts of those charged with the management of the company. The law therefore has to strike a balance on the protection offered to directors and the need to ensure that they execute their mandate with utmost due care. The logic behind is based on the fact that while it is indeed a separate legal person, a company is an artificial being only in the contemplation of the law. It has neither the mind nor the body of its own . It has to act through some physical persons and it these persons who formulate an intent and who act recklessly or fraudulently. They cannot therefore be excused merely because of the separate legal personality principle.

2.3 Derivative Action

The derivative action under the Companies and Other Business Entities Act states that;

> *"A member or shareholder of a company or private business corporation may bring an action in court in such person's name and on the company's behalf against any manager, officer or director referred to in sections 54 or 55 to enforce, or to recover from that manager, officer or director damages caused to the company by violation of, duties owed by that manager, officer or director to the company under this Act or any other law including laws against fraud or misappropriation."*[20]

It is important to note that the wording used specifically refers to a member or shareholder of the company. This may have a limiting effect on the parties who would be able to access the remedy in Zimbabwe. Some constituencies are left out such as employees and other third parties that have been recognized as worthy beneficiaries and have been included in other jurisdictions.[21] The restrictive nature of the derivative action in Zimbabwe is extended by Section 61 (3) which sets

[20] Section 61 of the Companies and Other Business Entities Act, No 4 of 2019
[21] See Section 165 of the South African Companies Act of 2008; Section of the Canadian Business Corporations Act; and Section of the Australian Corporations Act of 2001

out the conditions under which a derivative action may be instituted. The most restrictive condition is Section 61 (3) (c) which requires that a plaintiff wishing to access the derivative action in Zimbabwe must own 10% equity in the company.

Most pertinent to this study is the exclusion of an explicit "best interests" criterion within the derivative action in Zimbabwe. None of the conditions set out under Section 61 (3) make mention of the need to demonstrate that the intended derivative action should be in the best interests of the company. When this exclusion is considered in light of the business judgment rule it may have the inadvertent effect of limiting the consideration of best interests of the company to cases where a director is the one seeking to institute legal proceedings against the company. This reality only adds greater import to this study as it seeks to strengthen the understanding of the best interests criterion within the context of the business judgment rule where a director's decision to institute legal proceedings is under review.

In terms of South African Law, the duty of a director to act in the best interest of the company in conducting the company's affairs is a standard that also extends to any party wishing to institute legal proceedings on behalf of the company. Under section 54 of the Companies Act (2008) a directors of a company is required to act according to a similar standard hinged on the best interests of the company.[22] The courts have further extended this test to be conjunctively considered with the criterion of good faith[23].

The derivative action, as its name implies, is a derived action or right to institute legal proceedings or prosecute a right belonging to the company and on behalf of the company. It is derived from the company itself. In terms of the current law, it is available to shareholders, directors, employees or any other person who may elect to bring such action before the court.[24] The Act introduces a statutory derivative action in terms of section 60.

[22] Cassim FHI "The duties and the liability of directors" in Cassim FHI et al *Contemporary Company Law* 2ed (Juta and Company Claremont 2012) 516.
[23] *Mouritzen v Greyston Enterprise (Pty)* Ltd 2012 (5) SA 74 (KZD) [60].
[24] Section 60 of the Companies and Other Business Entities Act.

A shareholder may bring an action, in court in his or her name and on behalf of the entity against any directors/ members. The purpose of this action is to enforce or to recover damages from the director or members caused by violation if fiduciary duties owed to the entity or any other law, including laws against fraud or misappropriation.

Section 60 provides that a member or members acting on their own behalf against any director for breach of good faith or want or care or diligence in that capacity may bring an action on behalf of the company. The litigant concerned must apply to the court for leave to bring an action or continue legal proceedings on behalf of the company where the company has failed to take necessary steps in terms of a demand served upon it.

In the face of continued of corporate bankruptcies, poor performance of entities, and shareholder losses resulting from the economic downturn, shareholders are being pushed to seek recourse from derivative suits in an effort to hold someone responsible for their financial losses. Corporate directors stand in a fiduciary relationship of trust and confidence with the corporation and its shareholders. As fiduciaries, corporate directors owe the corporation and its shareholders fiduciary duties of diligence and fidelity in performing their corporate duties as articulated in terms of section 54 of the Act. These fiduciary obligations include the duty of care, skill and the duty of loyalty. "In essence, the duty of care consists of an obligation to act on an informed basis; the duty of loyalty requires the board and its directors to maintain, in good faith, the corporation's and its shareholders' best interests over anyone else's interests.[25]"

A proper understanding of the action must take into account some of the accompanying or foundational principles of company law preceding it. Most paramount amongst these is the majority principle and the proper plaintiff rule. The derivative action is an effective remedy that qualifies as an exception to the proper plaintiff rule.[26] The rule, which has its foundations in English company law, is founded on the fundamental principle that says that A cannot, as a general

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[25] L.C Llewellyn; Spring 2013 issue of Commercial & Business Litigation, Vol. 14 No. 3. ©2013 American Bar Association, 321 N Clark St, Chicago

[26] Cassim M F *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (Juta and Company Claremont 2016) 74.

rule bring an action to recover damages on behalf of C for an injury done by B to C.[27] It maintains that only the company can be the plaintiff in a matter and not the shareholders.[28] It stems from the recognition that the company is a juristic person and therefore a separate entity from its shareholders, employees or directors.[29]

2.4 The Fiduciary duties

A fiduciary duty is one where a person is in control of the assets of another. A fiduciary stands in a position of trust and confidence to another, i.e. a director stands in a fiduciary relationship with regard to a company. The fiduciary duties are largely derived from the English common law and entail acting honestly and for the best interests of the company[30]. They are founded upon the concepts of honesty, loyalty and good faith. Incompetence without more should accordingly not be regarded as a breach of fiduciary duty. There is merely a relationship of trust between the company and the director, with the director undertaking to act on behalf of the company, and therefore subsequently the director is under the duty to act in the best interests of the company[31].

To put it contextually, a fiduciary relationship may be further defined as a special relationship that is anchored on trust and confidence. It arises when a fiduciary has the power to control or represent another who is at the fiduciary's mercy[32]. The manifestation of a fiduciary duty is not one that is cast in stone but depends on the factual circumstances of each matter including the substance of the parties' relationship[33]. *In Ghersi v Tiber Developments (Pty),* the court recognized that 'the ambit of the duty can change from time to time' and that '[t]he existence of . . . a [fiduciary] duty and its nature and extent are questions of fact to be adduced from a thorough consideration of the substance of the relationship and any relevant circumstances which affect the operation of that

[27] *Prudential Assurance Co Ltd v Newman Industries Ltd* (No2) CA [1982] Ch 204 [210].
[28] *Burland and Others v Earle and Others* [1902] AC 83 (PC) [93].
[29] *Salomon v Salomon & Co* [1897] AC [22].
[30] R Matsimela 'The Business Judgment Rule in South African Company Law: A Miss or Hit?' (2011) Company Law Hub Journal of Student Research Volume (1)
31Bristol and West Building Society v Mothew [1998] Ch. 1.
[32] Bristol and West Building Society v Mothew [1998] Ch 1at 18. Hospital Products Ltd v US Surgical Corporation (1984) 156 CLR 41 (HC of A) at 96 – 7.
[33] Volvo (SA) (Pty) Ltd v Yssel [2008] 3 All SA 488 (W) at 504

relationship'[34]. The nature of the relationship must therefore be interpreted and understood in light of the prevailing environment that is obtaining.

Company directors' duties in general and the duty to exercise reasonable care, diligence and skill in particular, have come under increasing global spotlight in recent years as a consequence of the past global financial crisis,[35] and the evolving international best practices in corporate governance. The credit crunch, which is widely accepted as having been the *sine qua non* of the global financial crisis, was a result of a sustained period of careless and inappropriate lending in the USA banking sector for instance. As a direct consequence of the major corporate collapses world-wide, many countries, Zimbabwe included spurred to critically consider whether directors of corporations were observing their fiduciary duties with the standard of care and diligence that investors legitimately expect of directors in an ever modernising commercial world.

2.5 The Duty of Care

A director primarily owes two distinct forms of duty to a company. These may be broadly divided between the fiduciary duties and the duty of care and skill. These duties together act to restrict the powers of directors. The duty of care and skill is owed to the company in general and not to the shareholders. Directors are required to manage the business of the company as a reasonably prudent person would manage their own affairs[36].

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[34] 2007 (4) SA 536 (SCA)

[35] There has been a steady increase in the amount of academic and legal practice journal articles in South Africa and at international level dealing with directors' duties and their interaction with the Business Judgment Rule which has become a new statutory defence for directors who face litigation for breaching their duties of care, skill and diligence. Such articles look at recent developments in countries such as the UK, Australia, Singapore, Germany, New Zealand, South Africa, the USA and many other countries who have experienced corporation law and corporate governance reforms. See A Reisberg "Corporate Law in the UK after Recent Reforms: The Good, the Bad and the Ugly" (2010) 316 *CURRENT LEGAL PROBLEMS Vol* 63 pp315-374; J Cassidy "Models for Reform: The Directors' Duty of Care in a Modern Commercial World"(2009)3 *STELL LR* 373-406; M Bekink "An Historical Overview of the Director's Duty of Care and Skill: From the Nineteenth Century to the Companies Bill 2007" (2008) 20 *SA Merc LJ* 95-116; N Bouwman "Modification of the Director's duty of care and skill" (2009) 21 SA Merc LJ 509-534. See also an article by a corporate lawyer in Germany T Zwinge entitled "Have Directors Duties Of Care And Skill Become More Sstringent? What Has Driven This Development? Is This Development Beneficial- An analysis of the Duty of Care in the UK in Comparison to German Duty of Care, copy which is available at http://ssrn.com/abstract=1591590.

[36] MM Botha 'The Role and Duties of Directors in the Promotion of Corporate Governance: A South African Perspective' (2009) 3 Obiter 702

A duty of care is a legal obligation which is imposed on an individual requiring adherence to a standard of reasonable care while performing any acts that could foreseeably harm others. It is the first element that must be established to proceed with an action in negligence[37]. The composite duty of care is vital to the development of corporate law in South Africa. It has been correctly submitted that "it is undeniable that the duty of care and skill is of paramount importance as it applies to all decisions directors make or should make were they to exercise their powers to the benefit of the company and its shareholders".[38]

It is accepted by leading authors that the paramount duty of company directors is loyalty to the company by observing utmost good faith towards the company and to act in the best interests of the company[39]. While discharging this responsibility, a company director is expected to, without fail, act with the necessary care, skill and with due diligence.[40] That makes the duty of care critical and even central to the proper and lawful discharge of directorial responsibilities. While there is a general acceptance that the nature of the relationship between the director and his company is a fiduciary one, it is becoming more apparent that to a certain extent this relationship cannot be explained by the elements of the agency theory alone. There is an emerging view that the nature of this relationship is *sui generis* as directors are not only required to act in the interests of the shareholders who voted them into office.

Directors obviously have a duty to advance the interests of the current collective body of shareholders. Nonetheless, over and above that, there are also interests of future shareholders as well as other stakeholders such as the environment, employees and creditors, which interests cannot simply be ignored by a serious modern day company director. Even though the enlightened shareholder value approach is SA's preferred policy approach according to the Act, and as acknowledged by many authors like Cassim *et al* Contemporary *Company Law* 522-523, the Act has a section 72(4) which appears to recognize *inter alia* the activities of the company as a good

[37] J J duPlessis, 'Open Sea or Safe Harbour? American, Australian and South African Business Judgment Rules Compared — Part 1' (2011) 32 Comp L 347
[38] Bekink (2008) *SA Merc LJ* 95.
[39] MM Botha *(Supra)*
[40] See Bekink (2008) *SA Merc LJ* 100. Also see

corporate citizen, which is an acknowledgement of stakeholder interests represented by the concept of Corporate Social Responsibility (CSR).

As fiduciaries, corporate directors owe the corporation and its shareholders fiduciary duties of diligence and fidelity in performing their corporate duties. These fiduciary obligations include the duty of care and the duty of loyalty. In essence, the duty of care consists of an obligation to act on an informed basis; the duty of loyalty requires the board and its directors to maintain, in good faith, the corporation's and its shareholders' best interests over anyone else's interests[41]. In bringing shareholder derivative suits, shareholders seek to impose liability on corporate directors for failing to carry out their corporate duties in accordance with this standard of care. An important and powerful defense to such derivative suits lies in the common law "business- judgment rule[42]" which is the focus of the present work.

2.6 The link between the Fiduciary duties and the Business Judgement Rule

The business judgment rule is the mechanism adopted to facilitate judicial respect for directorial decisions. It would not be fair to impose liability on every director whose decisions fall foul of bad luck.[43] Such a judicial deference position is based on the premise that it is the directors to whom the management of a business organization has been entrusted, and not the courts. The Directors are therefore best positioned to judge whether a particular act or transaction is helpful to the conduct of the organization's affairs or expedient for the attainment of its purposes[44].

Directors and officers are not ordinarily responsible for corporate ills because they are either acting as the company when they sign contracts or because they are acting as the agent of the company and the company is bound as principal. If personal liability were imposed on company directors and officers for all corporate debts it would create a disincentive to take risks with the company's

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[41] See D M Branson, 'TheAmerican Law Institute Principles of Corporate Governance and the Derivative Action: A View from the other Side' (1986) 43 WLLR 399

[42] J H Farrar, 'Business Judgment and Defensive Tactics in Hostile Takeover Bids' in Essays on Comparative Commercial and Consumer Law, D B King (Ed), Fred B Rothman & Co, 1992

[43] Aiello v Muhlenberg Regional Medical Center, 733 A.2d 433 (N.J. 1999)

[44] J. Leach, "The Correct Understanding of the Business Judgment Rule in Section 76(4) of the Companies Act 71 of 2008: Avoiding the American Mistakes", A dissertation submitted in partial fulfilment of the requirements for the degree LLM Commercial Law Specialisation, University of Cape Town, 2014.

business. The business judgement rule therefore establishes a presumption that directors' decisions are based on sound business judgment, and it prohibits courts from interfering in business decisions made by the directors in good faith and in the absence of a conflict of interest. A court will not substitute its judgment for that of the board if the latter's decision can be attributed to any rational business purpose.

Decision-making is thus a key and critical role that company directors have to play in the life of a company that they are appointed to manage. From time to time, the Directors have to make business decisions under not so perfect conditions. There is a constant pressure to balance the need to maximize profits from shareholders and accountability for how the directors exercise the powers at their disposal. Despite pressures involved in decision-making, the law requires that directors should exercise their powers in the best interests of the corporation.

In adopting the BJR, like South Africa, Zimbabwean law must seek to avoid a situation where the rule may lead to a "culture of apparent indifference or deliberate disregard on the part of those responsible for the well-being of compan(ies)"[45] in that the rule must not operate as an "insurmountable barrier" to liability. It should be self-evident that corporations are vital actors with society, and consequently that directors occupy positions of upon the economic growth of the country. Poor corporate governance and the associated corporate failures and scandals have an adverse effect on investors, employees and creditors.

Public confidence in financial markets may be negatively impacted which will have implications upon the economy as a whole. It may thus be said to exist a direct correlation between specific business judgments and the wider interests of the general public in South Africa. The adverse effects of decisions which are imbued by the breach of the statutory duty of care may accordingly have far wider effects than merely the dissatisfaction of shareholders. It is important to demarcate clearly what the correct position regarding the business judgment rule should be with regard to Zimbabwe as the country adopts this new concept.

[45] M Havenga 'The Business Judgment Rule - Should we Follow the Australian Example' (2000) 12 SA Merc LJ 28

2.7 The Business Judgement Rule and Good Corporate Governance Practice

Generally, put across in another way, there is no universally accepted definition of corporate governance but it is generally understood to mean the manner in which companies are directed and controlled. When issues of corporate governance are considered, the emphasis is usually on the role played by directors in running their companies and the interests to be considered in corporate decision-making. Indeed, the better managed companies will yield benefits for all, hence the focus on the role of directors in, inter alia, managing companies. This is the main reason why corporate governance is undeniably pivotal in the modern world and in particular the present work.

For the greater part of it, principles of good corporate governance are not statutory. An exception is in State Owned Enterprises in Zimbabwe wherein adherence to good corporate governance practices has been legislated in terms of the Public Entities Corporate Governance Act [Chapter 10:31]. In giving an appropriate interpretation to the business judgement rule, it cannot be overemphasized that apart from compliance with legislation there is need to take into account compliance with governance codes and good governance. Adherence to good corporate governance practices will provide significant guidance as to what can be regarded as conduct justifying exoneration from liability for directors. Courts should therefore, when determining whether a particular director meets the requirements of the business judgment rule, consider whether such a director has also complied with the corporate governance principles.[46]

Corporate Governance practices and recommendations contained in a number of codes such as the King III and the National Code on Corporate Governance in the case of Zimbabwe are not prescriptions. These guidelines are designed to produce a desired outcome of efficiency. King III for instance does not adopt a "one size fits all" approach to corporate governance practices. Instead, it articulates guidelines of best practice for optimizing corporate performance and accountability in the interests of the broader economy. The general approach is one of flexibility. If a company considers that a recommendation is incongruous to its particular circumstances, it is free not to adopt it.

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[46] L Muswaka; Shielding Directors against Liability Imputations: The Business Judgment Rule and Good Corporate Governance

2.8 The Business Judgement Rule and The Best Interest of The Company Concept

The legal position around the aspect of "best interests" of the company in as far as it applies to the Business Judgment Rule where a director's decision to institute a derivative action is under review requires clarity. This study will seek to assist the courts and legislature to incorporate a uniform and clear approach to determining this aspect of the Business Judgment Rule. Several arguments and principles from local and international approach will be advanced. It will be advised that the courts should solely consider the "best interests" requirement without combining it with any of the other elements mentioned under Section 54 (4) (c) in the Act. Whilst carrying out this assessment the courts should adopt a wide approach that seeks to evaluate as many variables impacting the value of the perceived derivative action. Although the finding made on each requirement should not be treated as exclusive. All the requirements must remain conjunctive. The test for "best interests" should instead be established to incorporate an approach that prioritizes the maximization of the value of the company. This will involve a consideration of loss sought to be avoided or recovered by the derivative action, the current financial position of the company and the loss that the company could possibly suffer due to the granting of the derivative action. The decisions of the court should leave the company in a position of the utmost financial stability.

CHAPTER 3

3.0. COMPARATIVE ANALYSIS AND INTERNATIONAL BENCHMARKS & TRENDS IN EVOLUTION OF THE BUSINESS JUDGMENT RULE

3.1 Chapter Introduction

Zimbabwe has heavily borrowed both its business judgment rule from other jurisdictions, taking lessons from countries in which the legal action has been codified into law such as Australia, Canada and South Africa. The BJR whose origins can be traced from America has been adopted in varying forms in Canada, Australia, and most recently South Africa. In the same vein, it can be stated that regarding the interpretation of what is in the best interests of the company. Ultimately, Section 54 of the Companies and Other Business entities Act bears strong resemblance to similar provisions from these foreign jurisdictions. Therefore, it is imperative that our courts be well poised to tackle legal questions arising from the BJR by strongly considering the jurisprudence offered by courts in these countries.

In every jurisdiction the BJR is provided as a means by which the court can sustain confidence in corporate decision making by affording directors the benefit of doubt and not retrospectively questioning their actions. Whereas the statutory derivative action is a remedy by which a suitable applicant may approach the court to obtain permission to pursue a claim or other legal proceedings on behalf of the company. Of particular note, it is interesting that the phrasing and treatment of the element of the best interests of the company varies across the different jurisdictions. Whilst some are similar to the position adopted by South African courts others may differ completely. This may reveal an interesting trend in emphasis and understanding of the manner in which the element is considered within the derivative action. This emphasis and understanding of the best interests will also assist in constructing a recommendation of how the courts should assess the duty to act in the best interests of the company in terms of Section54(4) (c).

3.2 AUSTRALIA

3.2.1 The Business Judgment Rule in Australia

In 1989, sensing the increased exposure to liability that directors faced in both the criminal and the civil areas, the Cooney report recommended that the business judgment rule be introduced into Australian company law. The rule should oblige directors to inform themselves of matters relevant to the administration of the company, and that directors *'should be required to exercise an active discretion in the relevant matter or, alternatively, to show a reasonable degree of care in the circumstances'*. However, the BJR was not inserted into Australian legislation until March 2000 on the backdrop of the CLERP policy papers.[47] Much like Zimbabwe and South Africa, the Australian version of the Business Judgment Rule is codified into law via statutory provision.

Section 180(2) of the Australian Corporations Act of 2001 sets out the Business Judgment Rule:

> *"A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:*
> *(a) make the judgment in good faith for a proper purpose; and*
> *(b) do not have a material personal interest in the subject matter of the judgment; and*
> *(c) inform themselves about the proper subject matter of the judgment to the extent they reasonably believe to be appropriate; and*
> *(d) rationally believe that the judgment is in the best interests of the corporation."*

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Of particular interest to this study is Section 180 (2) (d) which introduces the best interests criterion to the Business Judgment Rule under Australian law. What is most intriguing about the clause is its introduction of the rationality or reasonableness qualifying criteria. It states that the director must have a rational belief that the decision is in the best interests of the company unless holding that opinion would be considered unreasonable for a person in the position of the director.

[47] Corporate Law Economic Reform Program Act 1999 (Cth) sch 1 (13 March 2000), inserting the provision at s 180(2).

These two qualifying criteria have been considered in the prominent case ASIC v Rich[48] where the court took quite a disputed stance on how this clause was to be interpreted. It was the court's finding that the director's belief would be a rational one if it was based on reason or reasoning. Further, that the reasoning need not be convincing to the judge but it would not be a rational belief if there was no arguable reasoning process to support it.

Therefore, a director's decision would be rational if they could simply demonstrate that there was some form of an *'arguable reasoning process to support it'*.[49] This alone would be sufficient to demonstrate that the decision taken was in the best interests of the company.[50] Although reasonableness is considered in Canada, the bar is set much higher and is less forgiving. In Canadian law the reasonableness is assessed through a twofold approach, process and outcome. This is considerably more stringent than the position developed in *ASIC v Rich.* Although this interpretation was provided during the ASIC matter, the court did take note that this interpretation would lead to several challenges including departing from the American position

3.2.2 Best Interests under the Derivative Action in Australia

Uncertainty created the impetus for the introduction of the Statutory Derivative Action under Australian law. There was uncertainty as to whether the exact criteria that a court would use when deciding to grant leave to commence the derivative proceedings; there was uncertainty as to whether an applicant can expect to be indemnified by the company for the costs of the action; and finally, there was uncertainty about the effect of shareholder ratification on the impugned conduct.[51]

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[48] *ASIC v Rich* (2009) 236 FLR 1, 153 [7287].
[49] *ASIC v Rich* (2009) 236 FLR 1, 153 [7287].
[50] *Tarrant v Sphere Energy Corp*, 2018 ABQB 492 at 46
[51] Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998 (Cth), [6-11]-[6.17]; Law Commission *Company Law: Reform and Restatement* (NZLC R9, 1989) [564] and [568].

The aim of the statutory derivative action in Australia was to enable individual members of the company, with leave of the court and operated within a controlled regulated environment, to bring court proceedings on behalf of the company where the company has failed to do so.[52]

Under Australian jurisdiction, the best interests of the company are explicitly mentioned in the Corporations Act of 2001. It is stated that the court, in granting leave for a party to bring or intervene in proceedings on behalf of a company, must be satisfied that it is in the best interests of the applicant to do so.[53]

This requirement is most difficult to prove as there is much uncertainty in the interpretation and outcome.[54] Traditionally, when one speaks of acting in the best interests of the company, the courts have interpreted this as acting in the best interests of the shareholders as a whole[55] However, in recent times, much like in the rest of the Commonwealth, the definition of a company is slowly changing to include all other stakeholders such as employees, suppliers, customers, and the community and environment.[56] The difficulty for a shareholder applicant in a statutory derivative action case is whether he also needs to consider and satisfy the court that the proposed derivative action is in the interests of all the stakeholders and not just the shareholders.[57] Currently, there is no certainty in this area and the court could face a similar conundrum when deciding whether to grant leave for a derivative action because of the current political and social pressure to consider corporate social responsibilities.[58]

There is also uncertainty as to the amount of evidence to provide that the proposed derivative action would be in the best interests of the company. Some academics are of the view that

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[52] Thai L and Berkhan M "Statutory derivative actions in Australia and New Zealand: What can we learn from each other?" 2012 25 *NZULR* 373.
[53] Section 237 (2) (c) Australian Corporations Act 2001.
[54] Thai L and Berkhan M "Statutory derivative actions in Australia and New Zealand: What can we learn from each other?" 2012 25 *NZULR* 379.
[55] *Percial v Wright* [1902] 2 Ch 421. This is Percival
[56] Corporations and Markets Advisory Committee, Australian Government, *Report on the Social Responsibility of Corporations* (December 2006).
[57] Thai L and Berkhan M "Statutory derivative actions in Australia and New Zealand: What can we learn from each other?" 2012 25 *NZULR* 379.
[58] Thai L and Berkhan M "Statutory derivative actions in Australia and New Zealand: What can we learn from each other?" 2012 25 *NZULR* 379.

regardless of how one defines the term ‘in the best interests of the company’, the dilemma is that the shareholder applicant would still be facing the difficulty of showing his genuine intention to do the best for the company and not himself. The other difficulty for a shareholder applicant is that the defendant –directors are able to rely upon the business judgment rule to defend their managerial decisions in all cases, including at a preliminary stage when the shareholder applicant is attempting to prove that the derivative action applied for is in the best interests of the company. The business judgment rule has been used and misused in numerous circumstances within corporate law.[59]

In determining whether granting leave to an applicant is in the best interests of the company the fact that the applicant has a personal interest in the outcome of the action or the applicant has personal animus against other members of the company is not significant or decisive because this is common in the types of disputes that lead to derivative actions.[60] A proceeding to protect the interests of members as members from breaches of duty by the directors is likely to be in the best interests of a company as a whole, although that may not invariably be the position.[61]

It may be in the best interests of the company to grant leave for the company to bring proceedings against shareholders where there is a deadlock and the proceeding is a suitable means by which the deadlock can be resolved.[62] Joint venture companies in which no one shareholder has a controlling interest have a real potential to become bogged down in a stalemate where shareholders cannot agree how to conduct the business of a company. A grant of leave may be a suitable means by which to resolve deadlocks of that kind.[63]

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[59] Thai L and Berkhan M "*Statutory derivative actions in Australia and New Zealand: What can we learn from each other?"* 2012 25 *NZULR* 380.
[60] Robert P Austin and Ian M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis, 17th ed 2018) 762 [10.240.9] citing *Maher v Honeysett & Maher Electrical Contractors Pty Ltd* [2005] NSWSC 859 (Brereton J); *Ehsman v Nutectime International Pty Ltd* [2006] NSWSC 887.
[61] *Connective Services Pty Ltd v Slea Pty Ltd* [2018] VSCA 229 [120] (Ferguson CJ, Whelan and McLeish JJA) citing with approval *Slea Pty Ltd v Connective Services Pty Ltd* [2017] VSC 609 [159] (Robson J).
[62] *Metyor Inc. v Queensland Electronic Switching Pty Ltd* [2003] 1 Qd R 186 [10] (McPherson JA, Williams and Wilson JJA agreeing); *Fiduciary Ltd v Morning Star Research Pty Ltd* [2005] NSWSC. 442; (2005) 53 ACSR 732 [47], [51] (Austin J); *Ragless v IPA Holdings Pty Ltd*; (2008) 65 ACSR 700, 709–10 [35] (Debelle J, Sulan and Vanstone JJ agreeing).
[63] *Ragless v IPA Holdings Pty Ltd* (2008) 65 ACSR 700 [35] (Debelle J, Sulan and Vanstone JJ agreeing.

If sections 236 and 237 of the Act are capable of applying to a company in liquidation, it has been observed that where a company is being wound up the question as to what is in the best interests of the company will, as a general rule, be answered by having regard to what is in the best interests of the creditors.[64] Where there are no creditors the question may then be what is in the best interests of the contributories, being the shareholders. It may often be to their advantage to resolve the issues between them and to have the assets distributed to them.[65]

Where the company is a joint venture vehicle and one of the venturers alleges that the other has acted unlawfully causing the company loss, it will usually be appropriate to allow the complaining venturer to bring proceedings in the company's name against the other venturer and its representatives on the board, even though there are no shareholding interests other than those of the litigants and that the effect of success will be indirectly to benefit the complaining venturer proportionately to its shareholding.[66]

The Australian courts noted that derivative action should not be granted lightly. They raised the threshold for derivative action by indicating that this particular requirement is important and ought not to be considered in a prima facie way only.

In some circumstances, pursuing a cause of action would be contrary to the "best interest of the company". In light of this, the "best interest of the company" clearly involves a cost benefit analysis against the potential detriment. The phrase "best interest of the company" in Australian law focuses on the welfare of the company. Consequently, in *Gooze v Graphic World Group Holdings Pty Ltd*,[67] where the applicant sought a remedy entailing the winding up of a group of companies that were trading profitably. The court found that this could not be in the "best interest" of those companies, for their best interests would clearly entail continuing to trade profitably.[68]

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[64] *Charlton v Baber* [2003] NSWSC 745; (2003) 47 ACSR 31 [53] (Barrett J).
[65] *Ragless v IPA Holdings Pty Ltd* [2008] SASC 90; (2008) 65 ACSR 700 [38] (Debelle J, Sulan and Vanstone JJ agreeing).
[66] *Fiduciary Ltd v Morning Star Research Pty Ltd* [2005] NSWSC 442; (2005) 53 ACSR 732 [47] (Austin J).
[67] *Goozee & Anor v Graphic World Group Holdings Pty Ltd & Ors* (2002) 20 ACLC 1502.
[68] *Gooze & Anor v Graphic World Group Holdings (Pty)& Ors (Ltd)* (2002) 20 ACLC 1502.

In *Swannson v Pratt*,[69] Ms Swannson, a director, shareholder, and divorcee, had sought leave from the court to bring proceedings against her former husband Mr Highland based upon allegations of his involvement in alleged contraventions of his duties to RAPP as a director.

At the core of her grievance was a failure to obtain payment from proceeds owing to her from the company that she alleged Mr Highland had usurped for himself.[34]
The court in this case concluded that it was not in the best interests of the company to grant Ms Swannson the derivative action on the basis that she had another much easier way to recover this money and it could not be determined whether the derivative action would or would not be a fruitless venture on behalf of the company.

The Australian law courts in *Maher v Honeysett & Maher Electrical Contractors Pty Ltd* and *Ehsman v Nutectime International Pty Ltd*[70] have found that the fact that an applicant has an element of self-interest in the outcome of the action or a high level of acrimony against the other shareholders of the company will not necessarily be conclusive or even significant in assessing whether an application is in the best interests of the company, because this would occur frequently in the kinds of disputes which lead to derivative actions.

The reliance, by South African academics, on the Swanson v Pratt[71] case and others decided in the states of New South Wales and Queensland, in order to draw a comparison between aspects of the South African and Australian derivative actions has come under some criticism.[72] This is because the Australian Corporations law is federal in nature and not regulated by individual states. As such cases such as Swansson v Pratt[73] may be seen as having little value if it cannot be ascertained whether they have approval with the Australian High Court.

[69] *Swansson v RA Pratt Properties Pty Ltd* 2002 (42) ACSR 313.
[70]*Maher v Honeysett & Maher Electrical Contractors Pty Ltd* [2005] NSWSC 859; *Ehsman v Nutectime International Pty Ltd* (2006) 58 ACSR 705l.
[71] *Swansson v RA Pratt Properties Pty Ltd* 2002 (42) ACSR.
[72] N Locke "The new derivative action under the Companies Act : guidelines for judicial discretion, Maleka Femida Cassim" 2017 (4) *TSAR* 916.
[73] *Swansson v RA Pratt Properties Pty Ltd* 2002 (42) ACSR.

In addition, the modernised and flexible approach taken by the Australian courts in granting leave for the statutory derivative action has not resulted in an increase in the number of judgments.[74] This may have also inadvertently affected the probability of a case being heard in the High Court. Matters involving the best interests of the company within the context of a derivative action have been heard in the lower supreme courts, confirming and even relying[75] on the decision in Swansson v Pratt.[76] This although not fully authoritative does serve to shed greater light on how the derivative action has been interpreted and applied by Australian courts.

Perhaps one of the relevant developments in the Australian derivative action within the context of best interests is the definition of a third party within the Corporations Act. Much like its carbon copy[77] the South African Companies Act, the Corporations Act also has a rebuttable presumption when determining whether an application is in the best interests of the company. It is found in Section 237(3) and also includes applicants who are third parties amongst those whose applications are presumed to not be in the best interests of the company. However, unlike in its South African counterpart the Corporations Act goes further to define a third party in the context of the best interests of the company. Section 237(4) clarifies that

> *"(a) a person is a third party if:*
>
> > *(i) the company is a public company and the person is not a related party of the company; or*
> >
> > *(ii) the company is not a public company and the person would not be a related party of the company if the company were a public company; and*
>
> *(b) proceedings by or against the company include any appeal from a decision made in proceedings by or against the company*."[78]

[74] Cassim M F *The Statutory Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (LLD thesis University of Cape Town 2014) 156.
[75] *Pentridge Village Pty Ltd (in liq) v Capital Finance Australia Ltd* [2018] VSC 633 (24 October 2018)
[76] *Swansson v RA Pratt Properties Pty Ltd* 2002 (42) ACSR.
[77] N Locke "The new derivative action under the Companies Act: guidelines for judicial discretion, Maleka Femida Cassim" 2017 (4) *TSAR* 91.? CORRECT THIS REFERENCE
[78] Business Corporations Act

This clarification assists in circumventing the exclusion of applicants who are directors of the company, a key stakeholder in the derivative action process. Thus the Australian version averts a fatal defect[79] that has affected the Companies Act.

Most important is the Australian courts' interpretation of the role of a costs–benefit analysis in deciding whether granting the application would be in the best interests of the company. It is the Australian courts' view that the phrase 'best interests' directs attention to the company's separate and independent welfare which imports the familiar concept of the interests of the company as a whole.[80] Best interests, at least assuming the company concerned is solvent, will predominantly reflect the interests of shareholders in that capacity and the fact that such shareholders may derive some collateral benefit from the bringing or otherwise of the proceedings will often be of no concern.[81]

Generally, the Australian courts have not placed an imposing value on the consideration of costs versus the benefits when determining what is in the best interests of the company. There is no fixed test to determine best interests and there is no special standard of proof or any presumption or disposition against the granting of relief.[82] The court will always have regard to whether the benefits of the proceeding are outweighed by the costs and risks that the company would suffer in bringing them.[83] Whether or not an application under s 237 of the Act is final or interlocutory does not alter the requirement that an applicant satisfy the court on the balance of probabilities that the proceedings are in the best interests of the company.[84]

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[79] Cassim M F *The Statutory Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (LLD thesis University of Cape Town 2014) 45.

[80] *Daiwa Can Company v Barokes Pty Ltd* [2016] VSC 296 [60] (Sifris J) citing *Maher v Honeysett & Maher Electrical Contractors Pty Ltd* [2005] NSWSC 859 [44] (Brereton J). See also *Ehsman v Nutectime International Pty Ltd* (2006) 58 ACSR 705 [53]–[57] (Austin J).

[81] *Huang v Wang* [2016] NSWCA 164; (2016) 114 ACSR 586 [59] (Bathurst CJ, McColl JA and Barrett AJA agreeing).

[82] *Pentridge Village Pty Ltd (in liq) v Capital Finance Australia Ltd [2018] VSC 633 (24 October 2018) 257.*

83 Daiwa Can Company v Barokes Pty Ltd [2016] VSC 296 [61] (Sifris J) citing True Value Solar Holdings Pty Limited v Fernandez [2013] VSCA 27 [13] (Osborn JA, Neave JA and Priest JJA agreeing).

84 Huang v Wang [2016] NSWCA 164; (2016) 114 ACSR 586 [58] (Bathurst CJ, McColl JA and Barrett AJA agreeing).

3.2.3 Cost-Benefit Analysis: Australian Perspective

The position on cost-benefit analysis in Australian law is very important and worth noting. The Australian courts have declared in unambiguous terms that the criterion of the best interests of the company does not involve a 'cost-benefit' analysis of possible outcomes of prospective litigation.[85]

3.3 CANADA

3.3.1 The Business Judgment Rule: Canadian Approach

The BJR is not codified into law in Canada, instead the rule has been applied and adopted into Canadian law via the courts. Whereas Zimbabwean[86] legislation has made explicit provision for the BJR, Canadian courts apply the BJR whenever approached by parties seeking to review decisions made by the directors of a company.

The Canada Business Corporations Act (CBCA) at Section 122(1) establishes two distinct duties to be discharged by officers and directors in managing, or supervising the management of, the corporation (the various provincial statutes have essentially equivalent language):

Section 122 (1)[87] states that every director and officer of a corporation in exercising their powers and discharging their duties shall:

> (a) Act honestly and in good faith with a view to the **best interests of the corporation**; and (own emphasis)
>
> (b) Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Several basic policy considerations underlie the business judgment rule in Canada stemming from American and Canadian commentators[88]. The Business Judgment Rule empowers directors the freedom to formulate effective corporate policy. Second, the Business Judgment Rule encourages

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[85] *Metyor Inc (formerly Talisman Technologies Inc) v Queensland Electronic Switching (Pty) Ltd* QCA [2002] 269.
[86] Companies and Other Business Entities Act
[87] Business Corporations Act R.S.C., 1985, c. C-44.
[88] Exclusionary Tender Offers: A Reasonably Formulated Takeover Defense or a Discriminatory Attempt to Retain Control?» (1986) 20 Georgia Law Review 627 at 658, n. 139

competent people to become directors by removing the chilling effect brought about a fear of being held personally liaby for honest mistakes in judgment. Third, the Business Judgment Rule relieves courts of the burden of second guessing complex corporate decisions, a task for which courts often lack the necessary expertise, information and time. The Business Judgment Rule thus articulates the principle that although shareholders have a right to expect their directors to exercise due care and undivided loyalty to the corporation, they cannot expect directors to guarantee the success of their decisions.

First, the Canadian courts recognize that they are ill-suited to evaluate business judgments made by directors.[89]

> *The business judgment rule is grounded in the prudent recognition that courts are ill-equipped and infrequently called on to evaluate what are and must be essentially business judgments.... [T]he responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility.*[90]

Lax J. in *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc., [2002] O.J. No. 2412 (Ont. S.C.J. [Commercial List]),*[91] at paragraphs 152- 156, stated that the business judgment rule protects Boards and directors from those that might question their decisions. The directors need only make a reasonable decision, not a perfect decision. This approach brings to the fore the autonomy and integrity of a company and the expertise of its directors. Givent their knowledge and roles, they are ideally placed to investigate and consider first-hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the company and to guide its operation.[92]However, directors are only protected to the extent that their actions actually evidence

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[89] D. Block, N. Barton & S. Radin, The Business Judgment Rule: Fiduciary Duties Of Corporate Directors And Officers (Clifton, N.J.: Prentice Hall, 1987) at 1-22; S.S. Arsht, The Business Judgment Rule Revisited (1979) 8 HOFSTRA L. REV.93.
[90] *Crouse-Hinds Co. v. InterNorth, Inc.,* 634 E2d 690, 702 (2d Cir. 1980)
[91] *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.,* [2002] O.J. No. 2412 (Ont. S.C.J. [Commercial List]), at paragraphs 152- 156
[92]ibid

their business judgment. The principle of deference presupposes that directors are scrupulous in their deliberations and demonstrate diligence in.

A discussion on the business judgment rule in Canada would hardly be complete without mentioning the landmark Supreme Court Decision in *Peoples Department Store Inc. (Trustee of) v. Wise* 2004 SCC 68. [93]The facts briefly set out were that the Wise brothers acquired People's from Marks & Spencer in early 90s running it as a subsidiary of Wise and serving as directors on on both People's Board. And the Board of Wise. Wise elected to put in place a system to manage both company's inventory together, but problems occurred right way. People's ended up owing large amounts of money to Marks & Spencer, and went bankrupt. Marks & Spencer made a claim against Wise for electing to implement a system that was not in its best interest, as it was better from Wise but not for People's.

Considering the question whether the directors owed a duty to the creditors the court[94] held that most business decisions were made under difficult conditions with limited information. At the time they are made these decisions are neither unreasonable nor imprudent even in the light of freshly acquired information that was not readily available when the decision was made. The court concluded that it is the Business Judgment Rule that prevents the deciosn taken by the directors from being inequitably considered in light of information they never had at the disposal.

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3.3.2 Business Judgment Rule in Canada: Best Interests of the Company

As earlier opined one of the directors' decisions that can be reviewed by the courts is the decision to institute legal proceedings on behalf of the company. In this instance Canadian courts are most concerned with whether the decision can be ascertained to have been in the best interests of the company. Naturally, it becomes necessary to determine what robust approach has been relied on to make this assessment in Canada.

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[93] Peoples Department Store Inc. (Trustee of) v. Wise 2004 SCC 68
[94] Ibid at 64

In Canada, the criterion of best interest is best demonstrated within the ambits of the derivative action found in section 239 of the Canada Business Corporations Act.[95] The complainant brings a derivative action in the name of or on behalf of the company to enforce a right, duty or obligation enforceable by the company.[96] The derivative action is often used to enable a shareholder or other complainant to circumvent corporate management that will not take action to rectify a wrong where it may have been involved in or responsible for the wrong suffered by the corporation.[97] However, the remedy is not limited to claims against other shareholders or management.

In terms of the Act, the court may grant derivative action if it is satisfied that the application is in good faith and that it appears to be in the best interests of the corporation or its subsidiary that the action be brought, prosecuted, defended, or discontinued.[98] Much like the South African derivative action the courts in Canada have a residual discretion when granting the derivative action. If the complainant proves the three statutory prerequisites (namely, good faith, that the action appears to be in the interests of corporation, and that notice was given to the corporation) the court still retains a residual discretion to give or withhold permission.[99]

The phrasing of section 239 (2) (b) and (c) implies an intention that the two requirements be considered in relation to one another. The good faith requirement in subsection 239(2)(b) is linked with the requirement in subsection 239(2)(c) that the action be prima facie in the interest of the corporation or its shareholders.

While they appear to be two separate requirements, it is submitted that they appear in the same subparagraph for more than aesthetic reasons; they support each other. If the action is determined to be in the interests of the corporation or its shareholders, then it will buttress the applicant's contention that he is acting in good faith. Conversely, if the action is not in the interest of the corporation or its shareholders, then the applicant's good faith may be suspect. This view has

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[95] Business Corporations Act R.S.C., 1985, c. C-44.
[96] John A-Willies, Qc & John H Willies *Contemporary Canadian Business Law Principles and Cases* 10th ed (McGraw-Hill, Ryerson) 322.
[97] *ibid*
[98] *ibid*
[99] Cassim M F *The Statutory Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (LLD thesis University of Cape Town 2014) 97.

gained popularity amongst Canadian courts particularly in British Columbia where courts have consistently decided that the belief in the merits of the claim by the court is a proper factor and cogent evidence of good faith – a prima facie indication that the petitioner is acting with proper motives.[100]

In addition, to the *prima facie* approach to the best interest requirement, the dual interdependent view of the good faith and best interest requirement is another distinguishing factor of the derivative action in Canada. Canadian courts have held that the fact that the applicant has mixed motives for bringing the application does not necessitate a finding of bad faith.[101] The courts have also held that perceived self-interest, an existing shareholder dispute, or the fact that litigation followed a failure in negotiation are not, by themselves, evidence of bad faith[i] It has been further held that where the primary motive for bringing the application is the applicant's strategic needs in another matter in litigation, the application will fail.

With regards to the role of costs in guiding the court's discretion on whether to grant leave, the Canadian courts focus primarily on the strength of the case.[102] Under the South African Act the guiding criteria of the best interests of the company and the strength of the case are separate and distinct preconditions for the grant of leave.[103] Whilst in contrast, with the Zimbabwean position[104]the Canadian legislation does not contain an express threshold test on the merits and the judiciary generally assesses the strength of the case by using the criterion that the proposed claim must appear to be in the interests of the corporation.[105]

The phrase best interests of the corporation when considered in the context of the duties of directors in section 122(1)(a) of the Business Corporations Act does not simply mean best interests of the shareholders.[106] From an economic perspective, best interests means the maximization of the value

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[100] *Holdyk v. Adolph* [2010] BCSC 1411 [10]; *Lost Lake Properties Ltd. v. Sunshine Ridge Properties Ltd.*, [2009] BCSC 938 [56]; *Discovery Enterprises Inc. v. Ebco Industries Ltd* [1997] BCSC 4735 [72, 118].
[101] *Bennett v. Rudek* [2008] BCSC 1278 [57, 63].
[102] *Yan v. Ho* [2016] BCCA 93 [17].
[103] Stylianou A *Evolution of the Derivative Action as an Enforcement of Rights Mechanism under the Companies Act 71 of 2008* (LLM thesis University of Pretoria 2016) 36.
[104] Companies and Other Busines Entities Act
[105] Stylianou A *Evolution of the Derivative Action as an Enforcement of Rights Mechanism under the Companies Act 71 of 2008* (LLM thesis University of Pretoria 2016) 36.
[106] *Peoples Department Stores Inc. (Trustee of) v. Wise* [2004] SCC [68].

of the corporation.[107] Depending on the circumstances, best interests can include consideration of the interests of shareholders, employees, and others.[108] The main aim is to maximize the value of the corporation. It is best for a corporation to be profitable, well capitalized and with strong prospects. The deterioration of the corporation's financial stability should be avoided.[109] In Carr v Cheng[110] the court granted leave for a derivative application because it appeared to be in the best interest of a company as the core financial stability of the company also appeared to be threatened.

In concluding the Canadian approach, below is a brief analysis of a few selected cases that have shaped the approach to and application of the rule in Canada:

A. *Peoples Department Store Inc. (Trustee of) v. Wise*[111]

A major criticism of the People's judgment related specifically to the manner in which the court had proceeded to assess the best interest criterion. The Supreme court rejected the notion that the best interests of the company could be ascertained by also considering what was in the best interests of the shareholders particularly where a business is in debt and headed for closure as the situation was with People's. The court was of the opinion that the shareholders are an unnecessary constituency where the business was insolvent. Authors have criticized this view on the basis that the end goal of any business is its economic benefit. Shareholders, by reason of being the economic beneficiaries of the business, were a key constituency who were meant to be the ultimate beneficiary of the fiduciary duty exercised by the director[112]

B. *Arkansas Teachers Retirement System v. Lions Gate Entertainment Corp*

Within the context of the BJR, the requirement that the proposed action be in the best interest of the company was aptly captured in *Arkansas Teachers Retirement System v. Lions Gate Entertainment Corp.,* 2016 BCSC 432 (*Lions* Gate)[113]. Here the Canadian court looked at a director's decision to pursue a derivative action. The Board of Lions Gate appointed a special

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[107] *Carr v. Cheng* [2005] BCSC 445 [25].
[108] *Carr v. Cheng* [2005] BCSC 445 [25].
[109] *ibid*
[110] *ibid*
[111] *Peoples Department Store Inc. (Trustee of) v. Wise* 2004 SCC 68
[112] Darcy L. MacPherson, "The Supreme Court Restates Directors' Fiduciary Duty — A Comment on *Peoples Department Stores v. Wise*" (2005) 43 Alta. L. Rev. 383
[113] *Arkansas Teachers Retirement System v. Lions Gate Entertainment Corp., 2016 BCSC 432 [Lions Gate]*

committee to consider whether to proceed with litigation. The proposed derivative action was based on Lions Gate having agreed to pay a civil monetary penalty in the U.S. for filing misleading documents with the Securities and Exchange Commission. The Special Committee decided not to proceed with the proposed derivative action.

The court held that the special committee was to be accorded due deference under the business judgment rule. This was on the basis that the Special Committee was in the best position to assess the impact of the proposed litigation on the Company and determine whether to proceed was in its best interests.

More importantly the court proceeded to affrim both the prospects of success approach and the cost benefit analysis approach of weighing the relief sought against the inconvenience to be suffered. The court found that the petitioner must show that the potential benefits of commencing and pursuing the claim will justify the cost of the litigation and the inconvenience to the company, that a reasonable claim exists, and that there is some evidentiary foundation before the court. It is important to note that the court appraised several considerations made by the special committee namely the reputation of [the respondent], the cost of the litigation, the effect of litigation on its ability to attract high quality directors, [the respondent's] current financial success and the negative effect of distracting the upper management from running the company, and found that they were all reasonable considerations.

3.4 SOUTH AFRICA

3.4.1 The Business Judgement Rule Application in South Africa

Section 76(4) of the South African Companies Act sets the Business Judgment Rule in that jurisdiction.[114] In terms of the rule, a director is protected from allegations of breach of the duty to act in the best interests of the company and with care, skill and diligence in relation to a matter where that director has (i) taken reasonably diligent steps to become informed about the matter, (ii) either had no conflict of interest in relation to the matter or complied with the rules on conflict

[114] *Moonisami v Palani and Another* (CT008Sep2017) [2017] COMPTRI 110 (18 December 2017)

of interests and (iii) had a rational basis for believing, and did believe, that his decision was in the best interest of the company.[115]

Very much like its counterparts in Canada and Australia the rule is used as a shield for directors against liability claims for issues such as a mere error of judgment. They are not required "to have special business acumen or expertise, or singular ability or intelligence, or even experience in the business of the company", but has to meet the test for the "reasonable" director.[116] However, the business judgment rule has various restrictions that must be complied with in addition to the requirements of the Act. The decision must be informed otherwise the rule will not apply.[117]

Although business decisions exist alongside these duties they are considered as entirely separate, distinct, and complementary.[118] The practice of South African courts has been to emphasize a separate analysis of whether or not a director has complied with these duties.[119] These duties apply whether or not a business judgment has been made. For instance, if the directors fail to monitor the affairs of the company, there could be liability under the duty of care, skill and diligence and the business judgment rule would have no application. The duty to act in the best interests of the company is discussed below.

3.4.2 Best Interests under the Business Judgment Rule in South Africa

There is no universal definition of what the best interests of the company are. South African authors have long characterized it as an indefinite phrase, requiring a case by case determination of its content.[120] Therefore, the directors have to define the best interests of the company in the respective given circumstances. The courts will restrain from defining the best interests of the company when the directors honestly believed that they acted for the sole benefit of the company.

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[115] South Africa Companies Act 71 of 2008

[116] Delport P and Vorster Q Henochsberg on the Companies Act 71 of 2008 on p 298(7) (Lexisnexis online version May 2016)

[117] *Moonisami v Palani and Another* (CT008Sep2017) [2017] COMPTRI 110 (18 December 2017)

[118] Davis *et al Companies and other Business Structures in South Africa* (2011) 16.

[119] Muswaka,L "Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis" *International Journal of Humanities and Social Sciences*

[120] Van Tonder *'An Analysis of the directors' duty to act in the best interests of the company through the lens of the Business Judgment Rule' (2015)* Obiter Volume 36 Number 3, 702 at 713.

Fundamentally, courts will not enquire the financial or commercial basis of a business decision.[121] The task of the courts is solely to examine the basis on which the directors build their decision, i.e. if there were reasonable grounds to believe the decision has been in the best interests and the directors actually believed to act in those interests.

In *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*,[122] the court was required to make a decision on the board's refusal to transfer shares from Visser Sitrus (Pty) Ltd to the Mouton Sitrus. When concluding its judgement, the court found that Visser Sitrus (Pty) Ltd had not alleged that the directors failed to take reasonably diligent steps to inform themselves of the facts relevant to the decision taken to refuse transfer of the shares. The directors had in fact been of the bona fide view that the best interests of the company would not be served by consenting to the transfer of the shares in question.[123] The court had no doubt that sufficient information was available for the directors to make a proper assessment. In that the directors had a rational belief that their decision was in the best interests of the company.[124] In the consideration of the action taken by the board to refuse the transfer of shares, the court found that it was in the best interests of the company to refuse the transfer of said shares.

The adoption of the Constitution as supreme law, with a Bill of Rights that binds private persons, has necessitated a reconsideration of the social dimensions of companies' responsibilities.[125] There has been a heightened awareness of the need to compel companies to comply with obligations flowing from the South African Constitution, particularly the Bill of rights. This is viewed as a critical progression needed in South Africa to limit the infringements of companies on the liberties owed to society.[126] The directors' fiduciary duty to act in the company's best interests, together with the business judgment rule and the court's general discretion to relieve directors of liability, embody normative concepts that require directors to make value judgments on company's social

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[121] Levin v Felt & Tweeds Ltd 1951 (2) SA 401 (A) at 414-15; Howard Smith Ltd v Ampol Petroleum Ltd [1974] 1 All ER 1126 (PC) at 1131.
[122] *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) at 81-83.
[123] *ibid*.
[124] *ibid*
[125] *Du Plessis v De Klerk* 1996 (3) SA 850 (CC) at 732E – F.
[126] John Ruggie 'Corporate responsibility to protect human rights' on a meeting convened by him in Geneva on 4–5 December 2007, available at http://www.reports-and-materials.org/Ruggie-Geneva–4-5-Dec–2007.pdf.

responsibilities. Such value judgments are influenced by various policy considerations and societal norms that are currently prevalent in South Africa.[127]

3.4.3 Best Interest under the Derivative Action in South Africa

The South African derivative action is contained in Section 165 of the Companies Act of 2008. It determines that a shareholder, director, trade union or a person granted leave by the court may first serve a demand on a company to institute or continue a legal action to protect the interests of that company. It further determines that the same party may further approach the court for permission to commence or continue legal action on behalf of the company. The statutory derivative action is available to a much wider class of participants compared to its Zimbabwean counterpart and it is not limited to wrongs committed by the management or the controllers of the company, it extends to wrongs committed by third parties and outsiders and offers ample scope for judicial control.

In South Africa the concept has become better understood through drawing an analogy with the 'best interests of the company' as used under the fiduciary duties of a director. According to this standard, the director "must act in a way which he conceives to be for the benefit of the company as a whole, as that concept is understood by the law". Thus the test is subjective as to means (how the company's interests are to be promoted), but objective as to ends (the interests to be promoted – "the interests of the company").[128]

In terms of the statutory derivative action, just as a director has a duty to act in the best interest of the company in conducting the company's affairs, so a minority shareholder who wishes to institute legal proceedings on behalf of the company under section 165 of the Companies Act ought to act according to similar standard hinged on the best interest of the company.[129] The duty of a

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[127] Minal Ramnath "Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration" 2013 27 Speculum Juris 2

[128] *Southern Resources Ltd v Residues Treatment & Trading Co Ltd* (1990) 3 ACSR 207 (SASC) at 223.

[129] Cassim FHI "The duties and the liability of directors" in Cassim FHI *et al Contemporary Company Law* 2 ed (Juta and Company Claremont 2012) 514 – 16.

director to act in the best interest of the company in conducting the company's affairs is a standard that also extends to any party wishing to institute legal proceedings on behalf of the company. Section 165(5)(b)(iii)) of the Companies Act states that a court may not grant leave to commence or continue proceedings on behalf of the company unless it is satisfied that it is in the best interests of the company that the applicant be granted leave. The Companies Act also states in Section 165 (7) that in assessing the best interests of the company, the rebuttable presumption in s 165(7) of the Act applies in certain circumstances. Amongst the conditions set out in the rebuttable presumption is that the directors who instituted the derivative action 'reasonably believed that the decision was in the best interests of the company' The rebuttable presumption echoes the well-established policy principle that the courts should have regard to the properly deliberated views of the company's directors on commercial matters, in line with the business judgment rule.

Under South African law, the best interests of the company criterion has been found to be wide-ranging and subject to different interpretations. However, prime factors to consider in the into the best interest of the company under section 165 of the Act would include the strength of the claim and its prospects of success, the costs of the proposed proceedings and the amount at stake as well as the positive advantage to the company.[130] In evaluating this principle, South African commentators have recommended the courts also take into account the potential damage to the company's reputation, negative effects on the company's relationship with its suppliers, customers, financers and adverse impact on the share price of the company.[131]

Going further, the concept of the best interests of the company has provided South African courts with an opportunity to consider the commercial feasibility of the application to continue or commence a derivative action even though there may be valid sustainable legal grounds on which the application is based.[132] However the question as to what importance South African courts should place on the economic benefits to be derived from a derivative action has remained a purely

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[130] Cassim FHI "The duties and the liability of directors" in Cassim FHI *et al Contemporary Company Law* 2 ed (Juta and Company Claremont 2012) 514 – 16..

[131] Cassim FHI "The duties and the liability of directors" in Cassim FHI *et al Contemporary Company Law* 2 ed (Juta and Company Claremont 2012) 514 – 16.

[132] Cassim M F "Judicial discretion in derivative actions in the Companies Act 71 of 2008" 2013 130 SALJ 778-779

academic one. Some views have favoured the notion that the best interests of the company should not be limited to a mere costs benefit analysis.[133]

Cassim MF has correctly proposed that the approach of the courts should be to 'weigh up the benefit' of the derivative action against the 'potential detriment'.[134] The statutory derivative action is directed not only at securing compensation for the company, but also at deterring future misconduct by directors and managers of companies.[135] Factors that are especially critical where the Business Judgment Rule is being considered. The word 'benefit' and 'detriment' should be interpreted to mean going beyond the direct costs of the litigation and the purely economic benefits. Much less importance needs to be placed on comparing the economic cost of the action against the possible economic return.[136]

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[133] Cassim M *F The Statutory Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (LLD thesis University of Cape Town 2014) 84

[134] Cassim MF "Judicial discretion in derivative actions under the Companies Act of 2008" 2013 130 *SALJ* 800.

[135] Cassim M F *The Statutory Derivative Action under the Companies Act: Guidelines for Judicial Discretion* (LLD thesis University of Cape Town 2014) 84.

[136] Cassim MF "Judicial discretion in derivative actions under the Companies Act of 2008" 2013 130 *SALJ* 800.

CHAPTER 4

4.0 SHAPING THE ZIMBABWE APPROACH TO BUSINESS JUDGEMENT RULE

4.1 Chapter Introduction

Zimbabwe finds itself in a generally hyper-inflationary economic environment. Such an environment results in a very thin line between innovation and illegality in as far as company activities are concerned. Due to the economic environment, which is generally harsh, directors are forced to adopt not so ordinary options in order to sustain companies. The introduction of the business judgement rule will ordinarily provide a safe harbor for Directors who may ordinarily be susceptible to a derivative action.

As Zimbabwe adopts the rule, it is quite important to ensure that such is done and implemented in a manner that acknowledges or considers the peculiar circumstances of the country. Having analyzed how the rule has been implemented in other jurisdictions, the focus of this chapter is to postulate a framework for the application of the rule in Zimbabwe.

4.2 Overview of the Zimbabwe Economic Environment

The economic environment for Zimbabwe has largely remained turbulent characterized by significant policy reforms, inflation, power outages, erratic water supply and reduced aggregate demand across all sectors during the entire nine months under review[137]. At independence in 1980 the Zimbabwe dollar replaced the Rhodesian dollar at par at a rate which was higher than the American dollar[138]. Zimbabwean inflation has been on the rise since independence. This on its own shows that there were economic policies that failed to harness inflation or there was no seriousness by authorities to control it. Although this quickly deteriorated, it was not until the late nineties that a series of events led to the demise of the Zimbabwean dollar. The economy depends heavily on mining and agriculture, but political instability and protracted economic crisis have severely damaged the country's economic potential.

[137] https://www.zse.co.zw/wp-content/uploads/2019/11/ASUN_Trading_Update_-_19_Nov_2019-1.pdf

[138] Berger, S., 'Final humiliation for the Zimbabwe dollar as foreign currency legalised', The Telegraph, 10 September 2008, http://www.telegraph.co.uk.

In 2008 in an 18-month 'experiment', foreign currency was accepted as legal tender for transactions with a set number of retailers. Zimbabwe officially abandoned its local currency in 2009 after it had been ravaged by hyperinflation which topped around 231 million and introduced a basket of foreign currencies dominated by the United States dollar.

The African Development Bank has equally painted a similar proposition in describing the Zimbabwe economy. GDP contracted by 12.8% in 2019 due to poor performance in mining, tourism, and agriculture. Foreign currency and electricity shortages affected mining and tourism. Agriculture shrank about 15.8% due to cyclone *Idai* in March 2019, prolonged drought, livestock diseases, and currency shortages reducing the availability of inputs[139]. In 2019, Production of major minerals like gold, diamond and coal fell by more than 27% while production of maize, the main staple food, was less than half of its level in 2018, resulting in wide-spread food insecurity. Domestic demand weakened significantly as job losses and rapidly increasing inflation eroded disposable incomes of households while fiscal austerity kept government spending low[140].

Inflation has been increasing since October 2018, driven by monetization of sizable fiscal deficits of the past, price distortions, and local currency depreciation. Annual inflation reached 230% in July 2019 (compared to 5.4% in September 2018), with food prices rising by 319% in July 2019 while non-food inflation increased by 194%. The trade deficit also narrowed significantly in January-July 2019 as imports contracted by 31% (year-on-year) on the back of forex liquidity constraints and weak demand.

Recently, there have been efforts to improve the economic outlook for the country. It is in that respect that the Companies and Other Business Entities Act was promulgated. It is also in that spirit that the present research has been undertaken. Although Zimbabwe's economy has remained repressed, there has been some notable improvements recently. GDP expanded by an average of 2.6 percent over the past five years, but a severe contraction is forecast in 2020 as drought

[139] https://www.afdb.org/en/countries/southern-africa/zimbabwe/zimbabwe-economic-outlook
[140] https://www.worldbank.org/en/country/zimbabwe/overview

continues to affect agricultural output and energy production from hydropower and as the ongoing currency and liquidity crises hamper economic activity[141].

The government's ambitious economic reform program to promote and protect private enterprise, reduce the costs of doing business, and encourage foreign direct investment has the potential for positive results, but its implementation is hamstrung by the lack of government integrity and by flawed governance practices across many sectors.

For most major economic players, high and unsustainable debt, cash shortages, limited foreign exchange, and persistent shortages of essential goods are hampering meaningful economic recovery. Development spending and social service provision continue to be constrained. As the Zimbabwe dollar depreciates, local creditors lose the value of both their loans and payments on goods and services supplied to government, and external debt service becomes more expensive. The economy's downward spiral has fueled unemployment and poverty.

Heavy debt servicing raises sustainability concerns, with implications for macroeconomic stability and development. Lack of funding, high input costs, outdated machinery, inadequate infrastructure (particularly for energy), limited progress on land reform, and relaxing investment regulations are key challenges for private sector development. The country needs to invest $3.4 billion a year for 10 years for the modest recovery of its infrastructure.

Such an environment generally tends out to be tantamount to swimming in shark infested waters. Recent government interventions indicate the need to encourage entrepreneurship and risk-taking as the country progresses through uncharted waters. Architects of the ease of doing business have from time to time emphasized the need for regulation that does not 'have a freezing effect on responsible risk taking and commercial decision making'. It is therefore in this context that the rule was deemed necessary to be included and introduced in the Zimbabwe legal system.

[141] https://www.heritage.org/index/country/zimbabwe

4.3 Applying the rule to the Zimbabwe context

4.3.1 Shaping the approach to the rule

Corporate decision making in a volatile environment has resulted in directors having to execute their duties with the threat of liability looming over their heads. Uncertainty and potential litigation may thaw the enthusiasm, resourcefulness and tenacity that normally attends corporate decision making. Consequently, the economic challenges brought about by prolonged recession and divestment has been worsened as directors seek to avoid liability for their actions. On the other hand, the unstable economy and policy environment has also given rise to a lot of corporate maladministration creating an immense need for a more robust legislative framework to tackle corporate malfeasance.

As has already been reiterated, directors once appointed owe fiduciary duties to the corporations and shareholders that they serve. The key and paramount of these duties include the duty of care, as well as the duty of loyalty. Generally speaking, any breach of these duties is a sufficient ground for liability against such director(s), put simply breach equals liability.

With the advent of the new Companies and Business Entities Act, the introduction of the business judgement rule in our law will create a new perspective to this general proposition. As a herald of a developing global corporate law doctrine that seeks to protect directors from personal liability for decisions made in their capacity as a director, , the Business Judgment Rule is a timely addition to our jurisdiction. Directors can now enjoy immunity, so long as certain disqualifying behaviors are not established.

The challenges prevalent in the Zimbabwean economy create the need to apply the BJR in a manner that balances between two somewhat competing concepts, providing immunity to corporate decision makers and deterring corporate malfeasance. Although this is a common challenge within most jurisdictions, the conflict is greatly amplified within the environment attendant in Zimbabwe. Therefore, reality dictates that the courts in Zimbabwe must apply the Business Judgment Rule in a manner that can mitigate these challenges.

It is recommended that in assessing the duty of care and skill the courts should apply a strict and dominantly subjective approach as developed in South African jurisdiction[142]. Whilst there already exists significant jurisprudence in this regard the courts should seek to capitalize on the new impetus granted by the introduction of Business Judgment Rule in Zimbabwe. The aim should be to closely and narrowly assess compliance these duties in a context specific approach. This assessment must be separate from the fiduciary duties that are based on a relationship of trust wherein directors exercise powers and perform functions in good faith and in the best interests of the company.

In the Zimbabwean context and particularly with regards to the application of the business judgment rule in the derivative action scenario, courts must place a spotlight on the best interests' criterion. They must adopt a case by case approach where all facts are considered and weighed in assessing whether the directors have acted in the best interests of the company. It remains to be seen how the courts will choose to determine what is in the best interests of the company and what the courts are expected to consider in making this assessment. Indeed there is extensive International jurisprudence, where the best interests of the company requirement under both the business judgment rule and the statutory derivative action have been jointly considered. It would be advisable for our courts to incorporate and further develop this jurisprudence.

The discourse around this requirement must continue and eventually provide greater clarity on how Section 54 (4) (c) of the Companies and Other Business Entities Act ought to be applied. From foreign jurisdiction, case law has provided some guidelines which will assist in clarifying the ambit and application of this feature in the Business Judgment Rule. There is a need to evaluate and analyze case law in order to obtain a clearer perspective on what is meant by this component of the Business Judgment Rule. Clarity will better guide the courts on which factors to consider in making an assessment on this criterion.

The legal position around the aspect of "best interests" of the company where a director seeks to institute a derivative action and subsequently rely on the Business Judgment Rule requires clarity. This study has sought to assist the courts towards incorporating a robust, uniform and clear

[142] *Fisheries Development Corporation of South Africa v AWJ Investments (Pty)* Ltd 1980 (4) SA 156 (W).

approach to determining this element of the Business Judgment Rule. Several arguments and principles from international approaches have been advanced. It is therefore advised that the courts should evade a restricted or narrow approach of determining what is in the "best interests" of a company. Although the finding made on each requirement should not be treated as exclusive. All the requirements must remain conjunctive.

4.3.2 Assessing the best interests of the corporate

The test for "best interests" should instead be developed further to incorporate a wide-ranging approach that prioritizes the maximization of the value of the company. The courts must shy away from relying on a fixed test to determine best interests or a special standard of proof or any presumption or disposition against the granting of relief. A modernized and flexible approach should be used where it can be established as a certainty that the business decision was not a fruitless venture.[143]

A director's decision should not escape the scrutiny of whether it is yielding economic benefit to the company whatever the form of measurement of this benefit. Borrowing from the cost benefit analysis courts should determine whether a business decision made by a director has enabled the company to increase its value whether in real or abstract terms. The courts will be required to set out the parameters of assessing whether the real or monetary value of a decision, however, whatever the value added by the it must not be negligible. The court should be convinced that the decision materially improves the bottom line of the company.

This will involve a consideration of loss sought to be avoided or recovered by the business decision, the current financial position of the company and the loss that the company could possibly suffer due to the granting of the derivative action. The decisions of the court should leave the company in a position of the utmost financial stability.

However, the courts must also steer away from an analysis that is limited to purely economic benefits. In the context of an ever evolving and globalizing world, courts must leave room to

[143] Swanson v Pratt

consider other factors of value that may not be readily discernible in purely economic terms. In terms of this, the court can incorporate abstract factors such as goodwill and public trust.

On the other hand, business decisions should prevent a company from losing its value whether in real or abstract terms. The courts are encouraged to look at several factors including the costs associated with potential litigation against the company. It must be determined that the business decision was taken in the interests of all company stakeholders[144]. The view recommended here is a global one incorporating employees, directors themselves, third parties and most importantly shareholders as developed by Canadian, Australian and South African courts. The prioritisation of shareholders is in line with the understanding developed in People's[145] that shareholders being the ultimate economic benefactors of a company ought to have their interests proportionally prioritised where the best interests of the company are being assessed.

Ideally, an inclusive view of what is in the best interests of the company will ensure that the courts deter and consequently reduce the number of BJR matters brought to the courts. It has been aptly demonstrated by the Canadian courts[146] that a holistic view of the best interests of a company, that incorporates multiple stakeholders, will result in business decisions that proportionally look after the interests of all parties lessening the number of potential litigants in the future. Aspects such as financial stability, business continuity, compliance, and the spectrum of obligations attendant in the constitution such as environmental rights should not be ignored in assessing whether a decision is in the best interests of the company.

4.3.3 Assessing other factors

The Zimbabwean court's confidence[147] should grow in proportion to its experience in adjudicating BJR matter. The courts can be aided by developing their own unique range of

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[144] Arkansas Teachers Retirement System v. Lions Gate Entertainment Corp., 2016 BCSC 432 [Lions Gate]: The court looked at the relief sought by the application for a derivative action weighing this against the
[145] Peoples Department Store Inc. (Trustee of) v. Wise 2004 SCC
[146] Carr v Cheng [2005] BCSC 445 [25]
[147] Crouse-Hinds Co. v. InterNorth, Inc., 634 E2d 690, 702 (2d Cir. 1980) -The business judgment rule is grounded in the prudent recognition that courts are ill-equipped and infrequently called on to evaluate what are and must be essentially business judgments

measures that can assist the courts to determine scrupulousness and diligence of the business decision in a Zimbabwean context.

There are important parameters that must be observed in the application of the rule. A number of cases and their subsequent commentaries alike have had occasion to formulate the business judgment rule, typically that a director who diligently attends to his or her duties and exercises his or her best business judgment on the questions facing the board will not be held liable even if the judgment is faulty[148]. Admittedly, such expressions appear, perhaps, too compact and convey too little of the rule's limitations as a defense for decisions made. Based on a comparative analysis of other jurisdictions, it is quite apparent that several attempts in the jurisdictions examined have been done to shape the rule and its colour. At the risk of repetition, and perhaps of engendering some disagreement, the following statement of the business judgment rule is proffered:

> *"A corporate transaction that involves no self-dealing by, or other personal interest of, the directors who authorized the transaction will not be enjoined or set aside for the directors' failure to satisfy the standards that govern a director's performance of his or her duties, and directors who authorized the transaction will not be held personally liable for resultant damages, unless:*
> *(1) The directors did not exercise due care to ascertain the relevant and available facts before voting to authorize the transaction; or*
> *(2) The directors voted to authorize the transaction even though they did not reasonably believe or could not have reasonably believed the transaction to be for the best interest of the corporation; or*
> *(3) In some other way the directors' authorization of the transaction was not in good faith."*[149]

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148 Lewis, The Business Judgment Rule and Corporate Directors' Liability for Mismanagement, 22 BAYLOR L. REv. 157 (1970)
149 Arsht, S. Samuel (1979) "The Business Judgment Rule Revisited," Hofstra Law Review: Vol. 8: Iss. 1, Article 6 (Available at: https://scholarlycommons.law.hofstra.edu/hlr/vol8/iss1/6)

The above description of the business judgment rule largely embodies concurrently the substance of the rule and its subsequent principal limitations as a defense. Needless to say, there ought to be an affirmative directorial judgment. It must be borne in mind that where the concern is that by reason of inexcusable unawareness or inattention the directors failed to take corrective or preventive action in respect of an issue wherein something should have been done to prevent harm to the company, the business judgment rule provides no defense. This will largely apply where it involves the failure to act as opposed to the exercise of any judgment. In such cases, the appropriate question revolves around whether the directors acted with the degree of care expected of them in the discharge of their duties. But having made no deliberate decision, the defense that directors are not liable for honest mistakes of judgment is not available in such cases.

Our courts may take a cue from the dictum in People's [150] concerning business decisions that were made under difficult conditions with limited information. In the Zimbabwean context where such instances are highly likely to occur, this same principle must be applied in that decisions should be viewed strictly in terms of the amount of information that was available to the director at the time the decision was made. Zimbabwe's unstable policy and economic landscape means that most directors will make decisions that might in the future seem imprudent in light of new information emerging. The courts should be alert to this and vociferously protect the confidence of directors by firmly deferring to them in such instances. There is no doubt that this will go a long way in emboldening directors to perform their duties without fear of reprisal as intended in the foundation of the BJR

Within the context of a derivative action founded upon section 54 of the Act, in the absence of self-dealing, director defendants charged with responsibility for corporate losses injurious to a member or shareholder should not be held accountable unless plaintiff can show that they were guilty of "bad faith, negligence, or gross abuse of discretion." In accepting ones appointment as a director, it is not an unfettered statement that they possess such a perfect knowledge of the matters and subjects which may come under their cognizance, that they cannot err, or be mistaken, either

[150] *Peoples Department Store Inc. (Trustee of) v.* Wise 2004 SCC

in the wisdom or legality of the means employed by them. It is human nature to err and as such the law must take judicial cognizance of that fact.

The business judgment rule is anchored on the acceptance of the notion that persons of reason, intellect, and integrity would not serve as directors if the law exacted from them a degree of prescience not possessed by people of ordinary knowledge.

4.3.4 Assessing Reasonable Director Test

Whilst in Canada the courts have placed an emphasis on the skill and acumen of decision makers as espoused in *Arkansas Teachers Retirement System v. Lions Gate Entertainment Corp*[151], South Africa has traversed a different path and found that the director need not have any special skill or acumen but that the decision must be reasonable. The latter is considered fulfilled where the decision taken was an informed decision. It is proposed that the Zimbabwean courts should rely on both, alternating their choice to suit the circumstances at hand. A director of a large corporation with over ten years of experience in corporate practice should be expected to demonstrate the skill and expertise pursuant to an executive of their pedigree. Whereas a junior director should be assessed based on the reasonableness of their decision in light of the information they had at their disposal at the time of making that decision.[152]

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[151] *Arkansas Teachers Retirement System v. Lions Gate Entertainment Corp., 2016 BCSC 432 [Lions Gate]*
[152] *Moonisami v Palani and Another*

CHAPTER 5

5.0. CONCLUSION

Corporate decision making in a volatile environment has resulted in directors having to execute their duties with the threat of liability looming over their heads. Uncertainty and potential litigation may thaw the enthusiasm, resourcefulness and tenacity that normally attends corporate decision making. Zimbabwe is currently under economic distress and directors are making risky decisions daily, all in the hope of sustaining companies through these trying times. Such an economic environment has once again brought the laws of director's liability and corporate governance into interest. These directors may end up assuming personal liability for some of these decisions. The economic environment has largely remained turbulent, characterized by significant policy reforms (and uncertainties), high inflation and reduced aggregate demand across all economic sectors. On the other hand, the unstable economy and policy environment has given rise to a lot of corporate maladministration creating an immense need for a more robust legislative framework to tackle corporate malfeasance.

In the wake of corporate bankruptcies and shareholder losses resulting from the economic challenges, it is likely that shareholders may be forced to turn to derivative suits in an effort to hold someone responsible for their financial losses. Corporate directors stand in a fiduciary relationship of trust and confidence with the corporation and its shareholders[153].

The Companies and Business Entities Act [Chapter 24:31], in terms of section 54 (4) introduces the "business judgement rule" (BJR) in our law and this will create a new perspective to this general statement. The business judgment rule is a judicially created doctrine that protects directors from personal civil liability for the decisions they make on behalf of a corporation. It is a standard of judicial review of corporate director's and or officer's conduct. As a herald of a developing global corporate law doctrine that seeks to protect directors from personal liability for decisions made in their capacity as a director, the business judgment rule is a timely addition to our jurisdiction. Directors can now enjoy immunity, so long as certain disqualifying behaviors are not established.

[153] Bakari v Total Zimbabwe (Private) Limited (SC 21/19, Supreme Court Appeal SC 226/16) [2019]

It has been argued above that, given the increased burden of the statutory duty of care, it is in the interests of shareholders, directors and the judiciary to have the business judgment rule. The inclusion of the rule in the Companies and Other Business Entities Act is a progressive step in as far as Zimbabwe corporate law is concerned. The law must not impinge upon free enterprise – the business judgment rule will act as the mechanism which ensures this doesn't occur[154]. It is hoped that the rule will be an important factor also in drawing highly qualified individuals to become directors of corporates. The dictum of Judge Winter in Joy v North[155] best summarizes the importance of the rule:

> *"Although the rule has suffered under academic criticism, it is not without rational basis. ... [B]ecause potential profit often corresponds to the potential risk, it is very much in the interest of shareholders that the law does not create incentives for overly cautious corporate decisions. ...Shareholders can reduce the volatility of risk by diversifying their holdings. In the case of the diversified shareholder, the seemingly riskier alternatives may well be the best choice since great losses in some stocks will over time be offset by even greater gains in others. ...A rule which penalizes the choice of seemingly riskier alternatives thus may not be in the interest of shareholders generally."*

The rule serves to protect officers and directors from liability where they have made decisions in good faith and using appropriate procedures, even if those decisions turn out to be poor or unwise. At the core of the business judgment rule is whether courts should judge the reasonableness of directors' decisions. Judicial respect of directorial discretion and decisions is not the same as simply the abandonment of the judicial post. The judiciary retains the possibility of intervention in appropriate cases such as when there is fraud or self-interestedness which underlies a particular decision made[156].

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[154] K Chittur 'The Corporate Director's Standard of Care: Past, Present, and Future' (1985) 10 Delaware Journal of Corporate Law 505 at 507.
[155] 692 F.2d 880 (2d Cir. 1982)
[156] *Muchabaiwa* v *Grab Enterprises (Pvt) Ltd* 1996 (2) ZLR 691 (SC)

Corporate officials eligible for protection under the business judgment rule are not liable for breaching duties of care merely because they have made mistakes. In simpler terms the following may be the simplified requirements for protection under the rule. A director or officer who makes a business judgment in good faith qualifies for protection under the rule if the director or company officer:

a) is not interested in the subject of his business judgment;
b) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and
c) Rationally believes that the business judgment is in the best interests of the company.

The challenges prevalent in the Zimbabwean economy creates the need to apply the BJR in a manner that balances between two somewhat competing concepts, providing immunity to corporate decision makers and deterring corporate malfeasance. Although this is a common challenge within most jurisdictions, the conflict is greatly amplified within the environment attendant in Zimbabwe. Therefore, reality dictates that the legal system in Zimbabwe must apply the BJR in a manner that can mitigate these challenges.

It is recommended that in assessing the duty of care and skill that directors owe to a company, the courts should apply a strict and dominantly subjective approach. Whilst there already exists significant legal commentary in this regard, the courts should seek to capitalize on the new impetus granted by the introduction of BJR in Zimbabwe. The aim should be to closely and narrowly assess compliance of these duties in a context specific approach. This assessment must be separate from the fiduciary duties that are based on a relationship of trust wherein directors exercise powers and perform functions in good faith and in the best interests of the company.

In the Zimbabwean context and particularly with regards to the application of the BJR in the derivative action scenario (i.e. instances were personal liability is brought upon directors), courts must place a spotlight on what is in the best interest of the company criterion. They must adopt a case by case approach where all facts are considered and weighed in assessing whether the directors have acted in the best interests of the company in arriving at any decision that may have been made. It remains to be seen how the courts will choose to determine what is in the best interest

of the company and what the courts are expected to consider in making this assessment. Indeed, there is extensive international legal reasoning, where the best interests of the company requirement under both the business judgment rule and the statutory derivative action have been jointly considered. It would be advisable for our courts to incorporate and further develop this jurisprudence. From the comparative jurisdictions adopted above, case law has provided some guidelines which will assist in clarifying the ambit and application of this feature in the BJR.

The legal position around the aspect of "best interests" of the company where a director seeks to institute a derivative action and subsequently rely on the BJR requires clarity. It is therefore essential for directors and corporate officers, managers and so on to fully familiarize themselves with this new provision. Should any decision made turn out not to be the best and pose a risk of personal liability, such director will have the BJR to rely on for protection.

In conclusion, the policy underpinnings of the BJR mirrors those of immunities, as does the practical impact. This means that the business judgment rule, properly construed, would require the director to establish entitlement to protection by proving that all preconditions for application of the rule are met. The BJR is a crucial part in the balancing act between directorial autonomy, business risk taking, entrepreneurship and accountability, which is especially timely given the current economic climate.

As the rule will be implemented, new challenges are definitely expected and further research into the manner of implementation will be important. One of the key questions that will surely arise will be what instances should directorial accountability trump directorial authority? What is the appropriate level of judicial respect to directors' decisions that should be adopted within the corporate law sphere in Zimbabwe? Therein lies the crux of the problem which this work sought to lay ground on and to be further built as with particular references to how the courts will apply the rule.

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