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DEMOCRATISATION OF BUSINESS: ZIMBABWE'S NEWEST BUSINESS ENTITY

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INTRODUCTION

This article looks at the provisions of the Private Business Corporations Act [Chapter 24:11] of Zimbabwe (Hereinafter referred to as the PBCA). One of the criticisms of the companies legislation as it exists is that it is lengthy and too complex to understand. Its demands are too many and rigid, that it is not appropriate for the small businessman.

It is important to look at the provisions of the PBCA Chapter 24:11 to establish whether the provisions available offer any added advantages to the small businessman than what was currently on offer then. It is also necessary to compare these regulations with the law governing companies, partnerships and co-operatives in order to conclude whether there was an actual need for such new regulations in the form of a new Act or whether it would have been easier and even more advantageous to incorporate these rules or regulations in the Companies Act. The PBCA creates the latest business entity in Zimbabwe.¹

The intention of the Act is to provide a new form of enterprise which is most suitable for small businessman. This enterprise would enjoy liberalised regulations. It would be simpler to incorporate and at the same time enjoy the benefits of limited liability. Limited liability is a very important concept in business. It protects the investor from possible personal financial ruin if the business fails. However, it must be accepted that where there is such protection, it is essential to put in place some regulatory provisions for the protection of the other players in the field.

At the end of the day, the Zimbabwean PBCA looks more like a hybrid of the company and the partnership. It tries to attract the best attributes or characters of companies, partnerships and even co-operatives while trying to avoid their vices. However, it must be noted that while simplicity in registration and a relaxed regulation regime may have advantages, but there may be need for some necessary evils or rules for the protection of the minority in the establishment when the marriage goes sour or protection of outsiders before the business's life is ended. A good example would be the English case of *Ebrahim v Westborne Galleries* [1973] AC 360 where what started as a good 'marriage' in a successful partnership ended up with "acrimonious" divorce in a private limited liability company. The courts had to bend backwards to see that justice is done and wound up an otherwise successful company.

Thus in this field there must be some rules — within the business documents themselves for settlement of complex disputes, for the protection of members and the business itself and also third parties. This is a reality as soon as the enterprise ceases becoming a one man band.

It must be noted however that this enterprise is still new in Zimbabwe and its practical side has not been tested. It is still early to establish whether more small capitalists (especially

¹ Established by a Statutory Instrument in 1997. In South Africa a similar institution was established in 1984 by the Close Corporation Act 69 (1984).

indigenous ones) will choose this vehicle when joining the country's economic road. The success of this legislation would be measured by looking at, among other factors, the number of new businesses created under it and their ability to survive for a long time. In South Africa it was a success. Between 1985 and 1993, some 288, 020 corporations were registered as compared with 61 559 registered under the Companies Act.²

FORMATION

A private business corporation may be formed by one or more persons not exceeding twenty.³ There is no magic in the maximum number of members. In South Africa, the maximum is ten. In Canada it is fifty.⁴ In Zimbabwe it has always been believed that twenty is a reasonable number for effectively running a loosely regulated business.⁵ The minimum number for its formation is one. This is the case with limited liability companies under the Companies Act in most jurisdictions.⁶

Only individual natural persons acting in their own right may be members of a private business corporation. However, a minor may be assisted or represented by his guardian as a member of the corporation. There are some people who are prohibited from being members of a private business corporation. The intention is to keep the affairs of the corporation as simple as possible whilst at the same time protecting the corporation from persons of questionable morals.

A similar provision is to be found in the Companies Act Cap 24:03. What could have been added for the private business corporation is the provision on natural members.

The partnerships, associations, body corporate or other legal persons shall not become members whether directly or by nominee. Section 23(3) disqualifies the following from being members (save with leave of the court):

- a) any person who has at any time been convicted, in Zimbabwe or elsewhere, of theft, fraud, forgery or uttering a forged document, or perjury and has been sentenced therefore to an imprisonment without the option of a fine or to a fine exceeding two thousand dollars.
- b) any unrehabilitated insolvent.
- c) any person who is subject to any order under the Companies Act disqualifying him as a director.
- d) any person removed by a competent court from any office of trust on account of misconduct.

If a member dies or becomes legally incapacitated in any other way, his estate may become a member in his place without the necessity of amending the statement of incorporation.

When a disqualified person or body corporate becomes a member of the private business corporation, that membership is invalid. Further, he shall not benefit from its limited liability. Thus he shall be liable jointly and severally with the private business corporation for every

2 See J. Freeman. *Small Business & Corporate Form* (1994) 57 MLR p 555 at 578.

3 PBCA section 4.

4 The Canada Business Corporation Act 1975.

5 Maximum for partnerships is 20 — section 7 Companies Act Cap 24:03. Except those who belong to a designated profession or occupation.

6 Companies Act Cap 24:03 s 8. Even in the UK it is no longer necessary to have a minimum of two shareholders. 12th E C Directive.

debt of the business incurred while he so purports to be member. In other words, the corporation is still a separate business entity on its own but the transgressor is punished by not getting the protection of limited liability.

The members of the private business corporation must subscribe their names to an Incorporation statement in the same way shareholders subscribe their names to the Memorandum of Association of a company.

The Incorporation statement as per section 5 shall state the following:-

- a) the name of the private business corporation with "Private Business Corporation or PBC" as the last words.
- b) the postal address (in Zimbabwe and the registered office).
- c) the physical address.
- d) the full name of each member and his national identity document he may possess and his date of birth.
- e) the percentage of each member's interests in the private business corporation taking the total of members' interests as 100 per cent.
- f) the amount of each member's contribution to the assets of the private business corporation stating the extent to which each contribution is in cash or in property or services rendered towards the formation or registration of the private business corporation and stating the fair value of any contribution that is not in cash.
- g) the name and postal address of an accounting officer to whom the members intend to submit their financial statements in terms of section 47.
- h) the date of the end of the financial year of the private business corporation.

What must be noted here is that these requirements contain certain extensions of those in the Companies Act. The most important one which delves into the partnership arena is the one on contribution to the business assets (h). This may be either cash or services/property as long as this can be fairly computed. The contention here is that this provision could have been included in a modified Companies Act to apply specifically to the private business corporation.

The incorporation statement seems to serve the same purpose as the Memorandum of Association of a company. It also seems that the two have the same legal effect. Section 6(a) and (b) of the PBCA provide that the statement of incorporation shall be signed by every person who is to become a member of the private business corporation upon its incorporation and the person who is qualified to become the accounting officer. It is also provided that each member's signature on the statement shall be to acknowledge the correctness of each item in the statement and the fairness of any valuation included therein (in terms of service contribution). The effect of the signature shall be to indicate that he has no cause to believe that such valuation is unfair. Similarly the effect of the Memorandum and Articles on members and the company is contractual.⁷ The contract is two fold: between the company and the members, and between the members inter-se.⁸ Section 6(2) of the PBCA assumes that contractually the member acknowledges the correctness of items in the statement of incorporation and the fairness of any evaluation therein. This is a very innovative regulation and it is interesting. It is obviously intended to protect the enterprise from being torn apart by a multiplicity of suits on the basis of incorrect information and unfair evaluation of investments. The rationale would be that the signer of the incorporation

⁷ Companies Act: section 27.

⁸ *Wood v Odessa Waterworks Co* (1889) 42 Ch 636. It is deemed the company executed the contract as well.

statement is bound by his signature. Corporate lawyers are used to the concept of *caveat subscripto*. If the effect of the signature is contractual would it preclude the members bringing an action on the statement itself or the unfair evaluation? Does this oust the provisions of the Unfair Contractual Terms Act? The contention here is that this provision may stifle member democracy. This issue of fairness is an important one which cannot be left to the eyes of the members only. The Act here is simple but it is not being flexible enough.

Registration is effected by the Registrar upon payment of the prescribed fee. He will then assign a number to the private business corporation and endorse on each copy of the incorporation statement a certificate that the private business corporation is incorporated.

Such certificate of incorporation given by the Registrar in terms of sub-section 3 shall be conclusive evidence that all the requirements of the Act in respect of registration and matters precedent thereto have been complied with and the private business corporation is duly incorporated under the Act.

This registration process is supposed to be simple and straightforward so as to be easily understood by the ordinary man. However, unlike in the registration of co-operatives — which has exactly the same aim, the Registrar is not given a positive duty to assist in the incorporation of the private business corporation (an act which would have assisted the incorporation of such enterprises by those who are not in a position to engage professionals).

A private business corporation when registered shall enjoy limited liability. The members shall not be liable for the debts and obligations of the private business corporation. From the date of incorporation it shall be a body corporate enjoying all the advantages of limited liability, e.g. contracting in its own name,⁹ having perpetual succession and owning property. It shall have the contractual capacity of a natural person of full capacity in so far as a body corporate is capable of having such capacity and exercising such powers. These provisions on contractual capacity are identical to those of companies under the Companies Act 24:03 section 9. For this reason the activities of the private business corporation are not limited by the operation of the *ultra vires* rule. Section 13 provides that the constructive notice doctrine shall not apply to documents or other public statements of private business enterprises. However, just like under the Companies Act, the *ultra vires* rule doctrine has residual application.¹⁰ Section 5(2) states that the incorporation statement may state the objects of the private business corporation. This however is not obligatory. Section 12(c) provides for the possibility of private limitation of activities of the corporation by members contractually. This internal limitation will not invalidate transactions exceeding the objects even if a third party was aware of the limitation or not.

The members are given the same protection against losses made or which could be made due to *ultra vires* activities by the enterprise as in company law. Thus they as members, may apply to the court for an interdict restraining the corporation from entering into or completing the offending transaction. Moreover the court has the same wide discretion on application of a member, to order any member who entered into the transaction to compensate the private business corporation for any loss which may have resulted. The court would take into account whether the member against whom the complaint is made acted honestly and reasonably taking into account the circumstances of the case. It would use the rules of justice and equity to grant any remedy it sees fit. It would therefore not be

9 PBCA section 8.

10 See Artwell Gumbo "The Demise of the *Ultra Vires* Rule in Zimbabwe", ZLR 1996.

attractive for members to seek redress under this section for they may end up paying the cost if they do not win and if they win anyway, the benefit is the corporation's. But it is worth noting that unlike in the similar provision under the Companies Act 24:03, there is no right under the PBCA for creditors to take this action to prevent the entering into *ultravires* acts by the business.

BUSINESS NAME

The incorporators may choose whatever name as long as it ends with the words 'Private Business Corporation' or 'PBC' as required by the Act.¹¹ The starting point is application (upon payment of the prescribed fee) for a reservation of name.¹² The Registrar may under the provisions of section 14(1) refuse to register the business with certain name either because they are likely to give the impression that the business is in some way connected to the Government, authority or organisation (These names should not be used without permission having been received from the relevant authority.)¹³ Once the incorporators have settled for the business name, avoiding obstacles stated in section 14, the business will be registered with that name. The name shall then be continuously displayed on the outside of every office or place of business in a conspicuous position and in legible letters.

MEMBER'S LIABILITY AND LIFTING THE CORPORATE VEIL

As has been said *supra*, the advantage is for the small businessman to benefit from the concept of limited liability. That he will only be liable to the risk already made in the investment and no more.

There are circumstances when the Act does not afford the member such protection of limited liability. It is not intended here to delve into the theoretical issue of whether this non-protection amounts to lifting the corporate veil proper, or lifting it or merely punishing the member for non-compliance with a statutory provision.¹⁴

The first such instance when a member may attract personal liability for the debts or obligations of a pbc is based on the aspect of membership. The number of members for a pbc is strictly limited to between one and twenty.¹⁵ When the maximum number of members is exceeded then the Act lifts the corporate veil.¹⁶ Every member and purported member shall be liable jointly and severally with the pbc for every debt incurred by the pbc while the number of its members is so exceeded. This sub-section does not refer to knowledge of the situation. Thus it does not matter whether one knew or did not know of the position. On the other hand, if the pbc has incurred a debt whilst it has no member, then any person who knowingly caused it to do so will be liable jointly and severally with it for the debt. It must be noted that in both situations the private business corporation shall not cease to exist.

11 S 5(a).

12 S 14 2.

13 See section 14(a-e).

14 For such arguments see Pickering "The Company as a Separate Entity" (1968) 31 MLR 481 or Domaske (1986) 103 SALJ 224.

15 S 4, S 22.

16 S 221.

The second situation is where persons prohibited to become members of the pbc purport to be members (section 23(3)). Here however, their membership is invalidated by the Act.¹⁷ They still remain liable jointly and severally with the pbc for every debt of the corporation incurred while such purported membership continues.

The members of a private business corporation, unlike shareholders in a company, owe the corporation a duty of utmost good faith (*uberrimae fides*). The duty is also owed to other members. Thus it is two fold. This principle is similar to that of a partnership.¹⁸ It is provided that a member shall act at all times in what he believes to be the best interest of the pbc as a whole so as to preserve the assets, further the business and promote the purposes for which the business was formed. The phrase "what he believes" in section 26(2) means that the test here is subjective, taking into account the personal attributes of the individual. Here we are talking of people who may not have training in business management. Moreover the degree of care and skill required of a member is that which may reasonably be expected from a person of his knowledge and experience.

Breach of these provisions would result in an order for the compensation of the pbc for loss suffered. The utmost good faith principle here is important in that (as shall be seen) there is no separation between ownership of the private business corporation in the way shareholders own the company and its control or management. The member in a private business corporation combines the roles of shareholder and director, thus for the determination of the exact scope of his fiduciary duties the principles of company law and partnerships are combined.

Personal liability may also attach where there is default in complying with the provisions of S16 which requires the continuous display of the name outside the place of business and engraving it on its seal and business letters. This requirement is important because third parties doing business with the pbc must know what they are dealing with. S16(3) provides that any person acting on behalf of the business or permits the use of any seal or document which constitutes default shall be personally liable for any debt incurred by the private business as a result of such use unless the business duly discharges this debt. There is no joint and several liability. The intention is to protect both the third party and the business corporation. In the first instance, the third party would not have known that he was dealing with the business — (for lack of engraved name on the seal) and the business can only be bound if it actively embraces the debt by paying it. Thus the selection expressly provides for the extinction of liability if the private business corporation duly discharges the debt. Non-compliance with the provisions of S16 is also made an offence.¹⁹

Another similar section as above is section 17. This requires the provision by the pbc of names of members on all invoices, statements or letters of business. This is a provision which informs the third party of the managers of the business he deals with. Every person acting on behalf of the pbc or who issues or permits the issuing or sending of the letter shall be personally liable for the debt incurred as a result of the letter unless the pbc discharges it.

One other obvious situation when the corporate veil may be lifted is where the business has been carried on recklessly or with gross negligence or with intention to defraud any

17 S 23(4) (PBCA).

18 S 26 (PBCA).

19 S 16(2) (PBCA).

person or for any fraudulent intent.²⁰ The court may on application of interested parties declare that any person who was knowingly a party to the carrying on of business in such a manner shall be liable personally for all or any of such debts and other liabilities of the pbc. Here what is being punished is not merely lack of business acumen but disregard of all ethical principles. Such conduct will amount to intention to defraud or recklessness or gross negligence. This is intended to protect the corporation, the member and the third party.

MANAGEMENT

The management of a business entity is of fundamental importance in law. With companies, it is unequivocal that the day-to-day management of the business is a matter for directors.²¹ The management is however subject to the powers delegated them by the shareholders in the Articles of Association.²² It is contended that these powers would normally belong to the shareholders as owners. The PBC Act removes obstacles for members who wish to manage the firm. It marries principles applicable to partnership law and those which in practice are associated with the private company where the major shareholder who is owner is ordinarily the director of the company. This should present little problems as an institutional investor is in any way precluded from becoming a member of the private business corporation.²³

Like in the law of partnerships, every member who is not a minor shall act on behalf of the private business corporation for the purposes of its business. But the principle of separation between the member and the business is maintained in that the member only acts as agent of the business.²⁴

The principles of the law of Agency then apply to the acts of a member. The principal is bound in the following situations:

- a) where the acts of the agent are expressly or impliedly authorised or where he subsequently ratifies them.
- b) where the acts were done for carrying on, in the usual way the ordinary kind of business carried on by the pbc unless the agent had no authority to act or the third party had knowledge or ought to have knowledge of such lack of authority.

Where there is internal limitation to what a member can do in the corporation's by-laws, then this limitation is effective and the business corporation is protected from the effects of such acts only if the other party knew or reasonably ought to have known of the restrictions. The members are free to alter the rules of management by a three quarter majority vote at a meeting. For the management duties, no member is automatically entitled to remuneration unless this is provided in any by-laws or agreement between the members or them and the pbc.

The regulations are not stringent. The members are not obliged by the Act to hold any meetings. This is a matter of agreement in the by-laws. But any member of the corporation can call a meeting after giving reasonable notice of the time, place and purpose of the

20 Section 43.

21 *Bushell v Faith* [1970] 1 ALL ER.

22 See for instance Table A.

23 Section 23(1) supra.

24 Section 37.

meeting. The notice does not necessarily have to be in writing.²⁵ This is too much of a relaxation on the rules of meetings. It would be proper at least for effective management and practice to require (even for the purposes of evidence) that the notice, place and purpose be written. This is important because section 40(4) requires the pbc to cause minutes of all proceedings of minutes of its members to be entered in a book and if signed by the Chairman to be evidence of the proceedings and evidence that the meeting was properly convened and conducted. It is not necessary to require formalities such as period of notice of meeting, place where notices are send, propriety of procedure etc. Records are also very important where there is no centralised management.

In the management of the business, all members owe the business the duty of utmost good faith as already discussed supra. However, the PBC Act provides some do not code for the members under section 26(4-5). For example, that a member shall not exceed the powers conferred upon him under the Act and the private business corporation nor exercise such powers for a purpose other than that for which it is given. He shall not be interested directly or indirectly otherwise than as a minority shareholder in a company or debenture-holder, in any business which competes with that of the pbc. He shall not be personally interested directly or indirectly, in any contracts or other transactions entered into by the pbc. These provisions combine the fundamental duties or obligations of the agent in Agency law and the statutory duties of directors under company law for the protection of the private business corporation. This is important moreso in such a situation where the element of independent control of the action of management may be absent.

The private business corporation is obliged to keep accounting records as are necessary fairly to represent the state of affairs and business of the corporation. This is more stringent than the other provisions in the Act. Subsection 4 provides that the accounting records shall be kept in such a manner as to provide adequate falsification and to facilitate the discovery of any falsification. These must be preserved for six years from the end of the financial year to which they relate. Every member of the corporation has a duty to take reasonable steps to secure compliance with the requirements concerning accounting records though the business must have an accounting officer member. This is part of management. It is the duty of the members as managers of a private business corporation to cause financial statements to be made out within nine months after the end of every financial year.

PAYMENT OF DIVIDEND

Section 38 allows the PBC to make or adopt by-laws at any time regulating the management of its affairs. The payment of dividends is a matter of internal management. In companies, this noble act is left in the hands of directors. Shareholders are not merely by virtue of shares in the company, legally entitled to dividends.²⁶ This historically was due to the need to prevent the business returning capital to the shareholders, a process which would prejudice the creditors. Although the rule has been liberalised, the concern now is not really capital maintenance as such but company solvency. There is need to ensure that the business, whatever it does, remains solvent and able to pay its debts at any particular time. As a result the PBC Act prohibits direct or indirect payment of any dividend, repayment of any members' contribution or transfer of any property to a member by virtue only of his membership unless immediately after the payment or transfer, the private business

²⁵ Section 40 2.

²⁶ *Bushel v Faith* [1970] AC 1099, [1970] 1 AER 53.

corporation's assets, fairly valued will exceed its liabilities and it will be able to pay its debts as they become due in the ordinary course of its business.²⁷ This is a requirement now in company law under the Act on repayment of capital. With owner management it is important to protect perhaps further the capital of the enterprise in that management is highly likely to act in its own interests without much internal checks like in companies. This is perhaps more important taking into account the fact that these member managers would be protected by the limited liability factor. That there is a penalty for breaching these rules is right but it is better to prevent rather than to cure. The Act may have given the financial officer or members specifically tasked with this duty more responsibilities as far as capital maintenance is concerned. The accounting standards are understandably more demanding than the rest of the provisions here for the protection of the business itself.

In the regulation of business conduct, it is important to balance the interests of the various actors involved both through the Act itself and by common law. What appears from this consideration is that there appears to be few, if any, advantages in using the private business corporation as created by the PBC Act rather than the company as we know it now. The fundamental difference with the partnership is the lack of protection of limited liability which is very important in business. The rules of business entities exist to further socially and economically desirable ends.

It therefore remains to be seen through practice whether such relaxation and simplification of regulations would result in attracting more indigenous business under this umbrella and whether the various interests would be well balanced so as to encourage growth of the enterprise. The contention is also that perhaps the same ends could have been arrived at by including these packages which are being portrayed as bespoke to private business corporations in the present Companies Act Chapter 24:03 without necessarily creating a new legislation. The new Act retains the most important features of private companies i.e. separate legal personality, limited liability, contractual capacity, need to file financial statements while liberalising others especially those relating to indoor management e.g. distinction between members and management.

27 S 42(1)



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