Claiming Damages where Dividends remain Unpaid: A Contribution towards a More Balanced Approach in South Africa

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Date published

2 November 2017

Editor Prof Klaus Beiter

How to cite this article

Kilian CG and Snyman van Deventer E "Claiming Damages Where Dividends remain Unpaid: A Contribution towards a More Balanced Approach in South Africa" *PER / PELJ* 2017(20) - DOI http://dx.doi.org/10.17159/1727-3781/2017/v20i0a1322

DOI
http://dx.doi.org/10.17159/1727-3781/2017/v20i0a1322

Abstract

In the matter between *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) the Supreme Court of New South Wales had to decide on the legal difficulty arising from unpaid dividends. The Court was required to decide whether a shareholder has a right to a predetermined annual dividend. The principles applied by the Supreme Court entailed estoppel (common law), minority oppression (company law) and contractual law principles. Although the principles of estoppel were relevant, these fall outside the ambit of this article concerning unpaid dividends. The Supreme Court cited approximately 40 cases and considered 5000 pages of documentary evidence pertaining to the contractual right to a predetermined dividend. Although the latter seems applicable and relevant to the South African corporate law environment, South African case law does not support it. Besides a contractual right, this article also investigates the *Oxford Legal Group* case in establishing at least an implied right (based on the doctrine of proper purpose) to claim an undeclared dividend or unauthorised dividend that is contrary to the board of directors discretion not to authorise any dividends. Both these cases argue when and why a court should interfere in company resolutions in striking a better balance between a right to a dividend and a company's discretionary power not to recommend or declare a dividend.

Keywords

Dividend, distribution, damages, proper purpose, implied right, declare a dividend, shares, profits for dividends.

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1 Introduction and background

Claims for damages in the event of the non-payment of dividends present an interesting economic reality that must be viewed from the company as well as the shareholder's perspective.[1] To shareholders, the payment of a dividend is important, as it indicates growth in their investment portfolios in terms of the return on investment (ROI) ratio. For a company, non-payment contributes favourably to its ability to grow financially or settle its debts in the course of business. But which of these two sides should receive preferential treatment in company law?

It is frequently argued that the courts are reluctant to interfere in the discretionary power of the board, or to assist the general meeting of shareholders, as shareholders always have the option of selling their non-performing shares to fellow shareholders or the public. In terms of the law, however, this statement must be qualified on two grounds, namely that the constitution of a company represents a contract, and that the avoidance of paying dividends can imply a claim for damages.[2] Although the latter seems applicable and relevant to the South African corporate law environment, South African case law does not support it. Therefore this contribution consults relevant Australian and English case law, and identifies valuable principles laid down in those jurisdictions on the disputability of a company board's discretionary powers as well as the importance of a company constitution in establishing a right, or at least implying a right, to claim an undeclared or unauthorised dividend and/or a declared or authorised dividend that is not paid.[3] It is hoped that the judicial precedent in the United Kingdom and Australia may guide South African courts to possibly put forward a more balanced legal approach than the current one of simply not granting any damages at all.

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1 In this regard see *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 537; Visser *et al South African Mercantile and Company Law* 245-266; Cilliers *et al Corporate Law* 85-86.

2 See Kilian 2007 *THRHR* 391.

3 See in general Tyler 1987 *HKLJ* 230-236; Cassim *Practitioner's Guide* 116. The 1973 *Companies Act* in table A referred to declaring and recommending a dividend. The 2008 Act, however, refers only to authorised distributions and does not require shareholders' approval, unless prescribed in the memorandum of incorporation.

If a dividend is declared but the company fails to effect payment, one may argue the existence of a personal right. On the other hand, in the event of an undeclared dividend it is problematic to make the same assertion. It is always possible to argue that the general meeting of shareholders will eventually vote for a dividend to be declared as such if it is a procedural requirement in the memorandum of incorporation. This statement is largely based on the English matter of *Prudential Assurance Co Ltd v Newman Industries*,[4] where the Court of Appeal extended the rule laid down in *Foss v Harbottle*[5] and shed some light on why the courts may be reluctant to give effect to a personal right within company law principles:

> An individual shareholder cannot bring an action in the courts to complain of an irregularity (undeclared dividend) in the conduct of the company's internal affairs if the irregularity is one which can be cured by a vote of the company in general meeting (would eventually declare a dividend).[6]

However, to allow the general meeting the opportunity to declare a dividend, the board of directors should in the first instance have recommended a dividend for payment.[7] Without such a recommendation, it will be very difficult to claim the existence of either a personal right or a debtor-creditor relationship. These difficulties are the direct result of the *Foss* matter, where the court described a company as an abstract entity existing largely in abstraction, with the board of directors on the one hand, and the general meeting of shareholders on the other.[8] In many respects, this case still serves as the foundation for the current South African company law position on dividends.

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4 *Prudential Assurance Co Ltd v Newman Industries* No 2; CA 1982, as cited in Sealy *Cases and Materials* 503.

5 *Foss v Harbottle* 1843 67 ER 189, as cited in Sealy *Cases and Materials* 478.

6 Pretorius *et al Hahlo's South African Company Law* 389.

7 See Cilliers *et al Corporate Law* 225, 355.

8 Jaffey 1994 *Denning LJ* 91; Jaffey 1996 *JLS* 32. It is not clear whether the payment or non-payment of dividends is entirely a management or business decision – the board recommends and the general meeting of shareholders declares the dividend. If either the recommendation or declaration is lacking, no dividend right exists in the law. Also see Van Rooyen 1989 *TSAR* 593, who argues for void decisions taken by the general meeting of shareholders in the event of the abuse of the majority voting power. On the one hand, it is possible to argue for abuse only when the minority shareholders' rights are changed. A dividend, however, is not a right; thus, technically, it will be difficult to argue for a void majority decision on that basis. On the other hand, Van Rooyen indicates an objective test of whether the majority decision is in fact beneficial for the company, thereby tacitly indicating "fiduciary duties" for the general meeting of shareholders. Further consult Bainbridge 1998 *Vill L Rev* 741: "… a transaction must make at least one person better off and no one worse off". Vagts 1996 *Harv L Rev* 48; Blair and Stout 2001 *Univ Pa L Rev* 1810. Not to declare or recommend a dividend could be an example of opportunistic behaviour.

In recent years, the so-called "merry-go-round" theory suggested by Esser and Du Plessis has gained some traction. Esser and Du Plessis have proposed that the company is represented by different interests, including the interests of shareholders, employees, the community and the environment, collectively forming the "merry-go-round".[9] This implies that, as the company conducts its business (and the participants move up and down as the merry-go-round rotates), different interests will enjoy preference at different times.[10] The art to be mastered by the courts is to know when preference should be given to shareholders' legitimate expectation of a dividend pay-out over the prerogative of the board of directors not to recommend a dividend, or of an annual general meeting of shareholders not to declare it.[11] After all, if the company is profitable, and neither the board of directors recommended nor the general meeting of shareholders declared a dividend, an individual shareholder should be able to approach a court of law on the basis of the merry-go-round theory.[12] To assist the South African courts in this balancing act, the study will therefore not only make the case for damages where dividends remain unpaid, but will also propose some practical solutions to the problem of calculating damages.

The following discussion of two case law examples from the United Kingdom and Australia respectively supports the merry-go-round theory and reveals certain principles that the South African courts may find useful in striking a better balance between shareholder dividend "rights" and a company's discretionary power not to recommend or declare dividends. The first is the matter of *Oxford Legal Group Limited v Sibbasbridge Services plc*[13] (hereinafter *Oxford Legal Group*), where the appeal court in the United Kingdom applied unique reasoning to imply a right when in fact no legal right exists. The principles identified in *Oxford Legal Group* will then be elaborated on in a discussion of the Australian matter of *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd*[14] (hereinafter *Sumiseki Materials*).

9 Esser and Du Plessis 2007 *SAMLJ* 346-360.
10 See in general Havenga *Fiduciary Duties* 333.
11 See in general Havenga *Fiduciary Duties* 326.
12 See Kilian 2007 *THRHR* 391.
13 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)).
14 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013).

2 The *Oxford Legal Group* case – the disputability of a board's discretionary power in the absence of a legal right

The decision of the Court of Appeal in *Oxford Legal Group* was an attempt to establish greater clarity on an important area in contemporary company law, namely the principles applicable to the existence (or non-existence) of a right to inspect the accounting records of a company. The facts of the matter were quite simple: Oxford Legal Group applied for a summary judgment against Sibbasbridge to entitle a director of Oxford to inspect Sibbasbridge's accounting records after the board of directors had exercised their discretionary power not to allow such an inspection. Although one may tend to think that an inspection of accounting records is rather different from receiving dividends, the significance of this case lies in its arguments on when and why a court should interfere in company resolutions.[15]

The inspection of financial records was at that time regulated by section 222 of the United Kingdom *Companies Act* 1985, which simply stated:

> A company's accounting records shall be kept at its registered office or such other place as the directors think fit, and shall at all times be open to inspection by the company officers.

Therefore Sibbasbridge relied on section 222 to refuse an inspection on the basis that the above provision did not create a right to inspection.[16] Sibbasbridge further argued that such an inspection would be a breach of fiduciary duties, as the director who requested the inspection would share the information with other persons in the public sphere or in the commercial world, which could potentially cause damage to the company.[17]

Importantly, even though the Court of Appeal eventually upheld the lower court's decision not to order the inspection of the financial records on a summary basis, the court reached this decision not because there was no such explicit or implied right but because the purposes for which the relevant director required the inspection were beyond enabling the director to carry out his functions in that capacity. Of more importance for this discussion is

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15 See Williamson 1983 *J Leg Ed* 210-216 and Marx *et al Investment Management* 5. The importance of alternatives constitutes the core logic of economic reasoning.

16 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 16.

17 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) paras 1-3, 16-17.

the court's reasoning on the board's discretionary power to refuse the director's request.

2.1 The court's reasoning on the board' discretionary power to refuse a director's request to inspect the company's financial records

In considering a remark by the lower court, which had stated that an inspection could cause the company irreparable harm, which would be a direct result of an assumed breach of directors' fiduciary duties in exercising business or management decisions,[18] the Court of Appeal held that no court would act on the mere presumption that such an inspection constituted a breach of fiduciary duties.[19] Instead, it had to be proved that the sole motive for the inspection was in fact to bring about a loss for Sibbasbridge in the form of the sharing of confidential information.

However, the court asked, if an inspection did not amount to a so-called right, as Sibbasbridge contended, could a right perhaps be assumed based on the doctrine of proper purpose? If a director exercises his or her discretionary power not to allow a person to inspect the company's financial statements[20] because the financial reports are regularly made available for review by any person, one may *prima facie* argue that the person requesting the inspection (whether a fellow director or shareholder) should in any event be aware of the financial position of the company.[21] On the other hand, should the financial manager of the company continuously blunder without the knowledge of his superior or the financial director,[22] it may firstly be said that the delegation of the directors' duties could be considered improper, even though it may have been made in good faith for the benefit of the company.[23] Secondly, it would be improper in such circumstances to refuse

18 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 17.

19 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 29.

20 See Hoffnagle and Butler 1972 *Conn L Rev* 707-733, who argue that shareholders should also have a "right" to inspect the financial matters of the company. This is possible only if the shareholder can establish a proper motive or purpose for such an inspection.

21 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) paras 28-29.

22 See *Ex Parte Buttner Bros* 1930 CPD 138, where the court interfered in directors' duties. Also see *Howard Smith Ltd v Ampol Petroleum Ltd* 1974 AC 821; Redmond 1991 *UNSWLJ* 100: "… trusting that official to perform such duties honestly".

23 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 34.

any director access to the financial records of the company[24] on the basis that a director has no explicit right in terms of the *Companies Act* to ask for an inspection or to view the financial statements, as this would deprive the director of the opportunity to ascertain the financial position of the company and/or to take the necessary action on behalf of the company to rectify the company's financial position.[25]

This finding of the Court of Appeal in *Oxford Legal Group* indicates that the board of directors' discretionary power not to allow an inspection[26] can in fact be challenged successfully even though the *Companies Act* does not create an explicit right to inspect the financial affairs/statements of the company.[27] This gives rise to the question whether similar reasoning can be applied in order to challenge the board's discretionary power not to recommend or declare a dividend.[28]

2.2 Applying the reasoning on discretionary power in Oxford Legal Group *to the dividend question in South Africa*

A rather useful analogy may be drawn between the expectation to inspect the books of the company (dealt with in *Oxford Legal Group*) and the shareholder's expectation to receive a dividend. Neither has been clearly defined as explicit rights by way of statute. In respect of dividends, the South African *Companies Act*[29] does not clearly provide for any shareholder's right to a dividend pay-out. However, although the "right" to company dividends is not explicitly catered for by legislation, the *Oxford Legal Group* reasoning presents some useful points that are equally relevant in making a case for such a right.

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24 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 33.

25 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 35.

26 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 37.

27 *Ex Parte Satbel (Edms) Bpk: In re Meyer v Satbel (Edms) Bpk* 1984 4 SA 347 (W) 351. "Lank voor hierdie stadium [vergadering] moes die belanghebbendes reeds al die tersaaklike inligting bekom het waarop hulle opinies en besluite rasioneel gebaseer kon word." [Long before this stage (the meeting), stakeholders should have already obtained the relevant information on which to rationally base their opinions and decisions.]

28 See Wester 1990 *Stetson L Rev* 602. The proper purpose can be extended to decide on dividend payments.

29 *Companies Act* 71 of 2008. See *Renard Constructions v Minister for Public Works* 1992 26 NSWLR 234, where the court held that the use of power, even that permitted by a clause in a contract, may be deemed unfair and/or beyond the scope of the agreement. Also see Tomasic 1995 *Canberra L Rev* 158.

A first option would be to argue that the discretionary power not to recommend a dividend could be for an improper purpose. Yet to convince a court of law that the board's discretionary power amounts to an improper purpose would not only be very difficult but would also be extremely technical. The argument for dividends will have to be based on accounting principles, and the financial affairs or statements of the company must indicate the availability of profits.[30] Nevertheless, as an alternative to the proper purpose doctrine, a second option would be to rely on the company's memorandum of incorporation, or its constitution, as it is also known. As a contract between the company and its shareholders, the company constitution may regulate company dividends as a personal right, irrespective of whether or not the board has recommended a dividend. In addition, it can create a contractual right to which the board's discretionary power to recommend a dividend may be subordinate i.e. section 46(1) of *Act* 2008 regulates personal rights, court orders and discretionary powers relevant to dividends.[31] The importance of a personal right that is contrary to the discretionary power to recommend a dividend is clearly illustrated in the Australian matter of *Sumiseki Materials.*

3 The *Sumiseki Materials* case – the company constitution as a contract regulating a shareholder's "right" to dividends

The Australian *Corporations Act* 2001 is similar to the South African *Companies Act* of 2008 in respect of a shareholder's right to dividends. In both jurisdictions, dividends are regulated by the law, and both jurisdictions accept dividends as a management decision. A court of law in both jurisdictions will not as a rule interfere in the payment of dividends.[32] This established rule/principle was analysed and tested in the *Sumiseki Materials* matter, where the Supreme Court of New South Wales had to decide on the

30 *Oxford Legal Group Limited v Sibbasbridge* 2008 WL 1741230 (CA (Civ Div)) para 35. See Kilian and Du Plessis 2005 *TSAR* 55.

31 Kilian 2007 *THRHR* 391. In this article a contractual *naturalia* right is implied by making use of *naturalia* relevant to the company's constitution, ie not in pursuit of self-interest, to challenge the board's discretionary power not to recommend a dividend. Also see Alevras and Du Plessis 2014 *C&SLJ* 312.

32 See Kilian and Du Plessis 2005 *TSAR* 48; Alevras and Du Plessis 2014 *C&SLJ* 312; Du Plessis 2010 *SALJ* 304. Also see the *Corporations Act*, 2001 in s 140(1)(a) and s 254U regarding the contractual nature of the company's constitution and the discretionary power to pay dividends. Also see the *Companies Act* 2008 in s 15(6) and s 46 regarding the contractual nature of the company's constitution and discretionary power to pay dividends. It should be noted that the *Companies Act* 2008 makes provision *inter alia* for dividends in terms of a legal obligation, and the latter was not previously part of the *Companies Act* 1973.

legal difficulty arising from unpaid dividends.[33] More specifically, the court was required to decide whether a shareholder had a right to a predetermined annual dividend. The Supreme Court cited approximately 40 cases and considered 5 000 pages of documentary evidence pertaining to the exclusivity of the board of directors' discretion whether or not to recommend a predetermined dividend.[34]

The business of the defendant in this matter (Wambo) was extracting coal from a mine about 16 km southwest of Singleton in the Hunter Valley region of New South Wales. The plaintiff (Sumiseki) was also in the business of extracting coal. From 1992 to 2001 Sumiseki invested $250 million in the Wambo mine by way of loans. However, as the Wambo mine was unprofitable, Sumiseki decided to sell its shares. Buy Out Group emerged as a potential buyer intending to purchase all the shares from Sumiseki. To effect the transaction, Buy Out Group used an investment vehicle (Hunter) to act on its behalf. On 10 January 2001 the sale to the investment vehicle of all Sumiseki's shares in the Wambo mine was completed.

This shares transaction with Hunter required a new agreement to regulate the respective parties' individual rights and duties. In terms of the new agreement, Sumiseki obtained the contractual right to receive a dividend from Hunter, which had to be equal to Wambo's annual profit.[35] If the dividends were unpaid, Sumiseki was entitled to interest of 10% per annum on the default payment. This contractual right was further complicated by a restructuring deal between Wambo and Sumiseki, which stated in brief that any existing debt between Hunter and Sumiseki had to be classified as class B shares with similar rights and duties in respect of dividends. Therefore Hunter owned all the ordinary shares and Sumiseki all the class B shares in Wambo.

Wambo's constitution was later amended to provide for class A shares in art 2.1A and for class B shares in art 2.1B, which read as follows: [36]

> Despite any provision in this constitution to the contrary, the holder of a B class share had the right to receive dividends determined by reference to 25% of a profit interest.

33 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013); Alevras and Du Plessis 2014 *C&SLJ* 312.

34 Alevras and Du Plessis 2014 *C&SLJ* 315.

35 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 6.

36 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 28.

The profit interest referred to above was the profits made by the company at the end of the financial year, which were also available for dividend payments. In addition, however, Wambo's constitution stated that the profits would depend on the board's discretion (clause 9.1a), that the profits might be transferred to a reserve fund as the directors deemed fit (clause 9.4a), and that so much of the profits as the board deemed fit not to pay out as dividends or to capitalise may be carried over (clause 9.5).[37] Clearly, art 2.1B would have been in conflict with the constitution were it not for the insertion of the words "[d]espite any provision in this constitution to the contrary", which ensured dividend payments.[38] Therefore, at least from a legal perspective, it is quite clear that class B shares were entitled to a dividend, irrespective of any contrary clauses regulating the payment of dividends subject to the discretionary power of the board.[39]

From 2007 Wambo suffered severe financial difficulties, and no dividends were paid from 2008. To justify the lack of dividend payments and to circumvent its contractual duty to pay dividends, Wambo's auditors argued that class B shares were in fact debt and not dividends in the true sense of the word: debt, they argued, was not part of company equity; a right to receive payment was a characteristic associated with loans or liabilities. Therefore, by implying that class B shares were actually debt, Wambo tried to prove that Sumiseki was not entitled to a fixed annual dividend. In addition, the auditors advised that any fixed dividend payments would contravene not only section 254T of the *Corporations Act*, but also Australian company law principles, which simply stated that dividends were not a right, but a discretionary payment.[40]

The argument raised by Wambo's attorneys and supported by its auditors was that dividend payments had to be viewed objectively – in other words, in terms of the test of the reasonable person. Although this may appear simple, it is in fact very technical when applied to company law and accounting principles. For example, if the company constitution states that profits are available for dividend payments but the board decides not to pay any dividends, the company balance sheet will obviously disclose available dividends for future payment. To a reasonable person, the availability of

37 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 29.

38 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 57.

39 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 11.

40 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 14.

profits for dividend distribution is certain; all that is uncertain is the actual payment.[41] The reasonable person does not conclude that no dividends will be paid in future. This uncertainty as to the actual payment of dividends can, however, lead to the depressing possibility that the company might "bank" the available dividends for up to ten consecutive years, making the dividends available only in year 11 or whenever the board decides to pay them.

To circumvent this difficulty, the court interpreted the company constitution in the same manner that any court of law would interpret a contract between parties.[42] The court held that the true objective of the parties was to participate in company profits on an annual basis. Besides this interpretation, the court also applied section 232 of the *Corporations Act*, which reads as follows:[43]

> The Court may make an order … if … (a) the conduct of a company's affairs … (e) is oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.

Determining the correct meaning of "oppressive" or "unfairly" required the application of the commercial bystander test, which is relevant to oppressive and unfairly prejudicial company conduct.[44] Even though the defendant's attorneys also relied on the debt-to-service ratio to avoid paying dividends, using a technical argument as to why this ratio was fair from an economic point of view, the court ruled that Sumiseki's right and expectation to receive annual dividend payments had to be upheld and that company law principles in this regard were subordinate to the principles of the law of contract.[45]

4 Awarding damages to a shareholder

4.1 The case for awarding damages where dividends remain unpaid

Although companies are artificial persons, with the board of directors as one organ of the company and the general meeting of shareholders as another,

41 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 135.

42 Alevras and Du Plessis 2014 *C&SLJ* 320.

43 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 215.

44 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 225.

45 *Sumiseki Materials Co Ltd v Wambo Coal Pty Ltd* 2013 NSWSC 235 (25 Mar 2013) 60-67.

technical interpretations of what constitutes a company and how dividends ought to be viewed should be avoided when such interpretations are intended to circumvent the shareholders' expectation to participate in company profits or, in other words, are designed to cause injury to the shareholders.[46] This is supported by both *Oxford Legal Group* and *Sumiseki Materials*.[47]

Sumiseki Materials also contains certain principles evident in the law of partnerships in South Africa. It is an implied term in the law of partnerships, for example, that all partners have a legitimate expectation to share in the partnership profits *in good faith*.[48] If profits are made and one of the partners is to be excluded from participating in those profits,[49] the cooperation between the parties is obviously in bad faith, and therefore the partnership cannot technically exist in law.[50] Interestingly, profits give rise to a contractual right, and should a partner not be participating in the profits,[51] his or her right to profit-sharing is protected by means of a partnership contract, which may for example entitle such a partner to a claim for the damages suffered.[52] The same reasoning could be relevant to company law, provided that a few obstacles are addressed.[53]

The courts have never before identified a company constitution as a specific kind of contract (i.e. a forward contract), which may be part of the reason why they have been reluctant to award damages to a shareholder whenever a company failed to pay a dividend, as shareholders always have the option of selling their non-performing shares to the public.[54] However, even if their

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46 See Esser and Du Plessis 2007 *SAMLJ* 358, who discuss the critical issues regarding shareholder expectations. Also see *Ex Parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W) 282, where a shareholder's prospect of dividends is defined.

47 Also see Rider 1979 *CLJ* 148; *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 537, where the court stated clearly that a company is in essence a partnership, of which the shareholders constitute the partners. Because a partnership is a contract between partners, individual partners' rights and duties flow from the contract itself or from implied terms.

48 Own emphasis. See Snyman *Remedies ter Beskikking* 18; Kilian 2007 *THRHR* 391.

49 See Correia *et al Financial Management* 299; Black, Wright and Davies *In Search of Shareholder Value* 40.

50 See Snyman *Hervormende Suid-Afrikaanse Vennootskapswet* 17, where the author discusses the importance of having legislation to regulate the difficulties associated with partnership law more clearly, ie the internal relationship of partners as well as the remedies. Also see Henning 1980 *Mod Bus L* 143, which explains the partners' participation in profits or losses in a leonine partnership.

51 See Pretorius *et al Hahlo's South African Company Law* 55, 174, 270.

52 See Visser *et al South African Mercantile and Company Law* 245-266.

53 See *Vasco Dry Cleaners v Twycross* 1979 1 SA 603 (A) 610; *Magwaza v Heenan* 1979 2 SA 1019 (A) 1024; Bainbridge 1998 *Vill L Rev* 772.

54 Kilian 2007 *THRHR* 391 indicates that the constitution is a forward contract. Also see Millon 1990 *Duke LJ* 230. As an example of why the courts are reluctant to award

reluctance can be justified as a method of creating legal certainty in the commercial world, the law can still be developed to award damages in appropriate circumstances.[55] The following section provides a few suggestions as to how this may be done in practice.

Although the payment of dividends and the amount of the dividends to be paid in the future will always be uncertain, being characteristic of a forward contract,[56] current facts and circumstances – such as the provisions in the company constitution, the growth rate of the company as well as the book value per share – prove useful in exploring the following simple ways to calculate damages.[57] In assessing the proposed methods set out below, it should also be noted that the actual amount of the damages payable is not as important for this study[58] as the process of considering and identifying different ways of arriving at a fair amount.[59]

4.2 Potential ways of calculating damages

Contractual damages and ROI: If the company constitution clearly stipulates that shareholders are entitled to dividends equal to 25% of company profits, such an amount is easy to estimate for the purposes of calculating damages. However, if the constitution is silent on the specific percentage of dividends, the following alternative may be considered: By identifying the discretionary historic dividends, the shareholder could calculate the ROI, as suggested by Kilian and Du Plessis.[60] For instance, if an initial investment (R5 000) in exchange for shares produces dividend returns of R1 500 in year one, R3 500 in year two and R1 400 in the final year for unlisted

damages see *Stewart v Sashalite Ltd* [1936] 2 All ER 1481, ie the probability that the company will pay dividends

55 See Golecki 2008 *MUJLT* 212: "… if some parts of the law are not promoting efficiency, such rules should be changed to reflect the [economic] efficiency attitude of the whole legal system". Also see Jehring 1963 *U Det LJ* 500. In South America, profit-sharing is mandatory in company law.

56 See Kilian 2007 *THRHR* 391. Also refer to Newberry 1995 *ABAJ* 60, where it is stated that uncertain future events must be subject to risk disclosures.

57 See in general *Novick v Comair Holdings Ltd* 1979 2 SA 116 (W); *Pietermaritzburg Corporation v South African Breweries Ltd* 1911 AD 501, 515, 516, 524.

58 See Kilian 2007 *THRHR* 391, where the author focuses on two formulas, both of which have a different end result in mind. The question posed is: When should one formula be subject to another? There is no clear answer. Also see *Ex Parte Strydom: In Re Central Plumbing Works (Natal) (Pty) Ltd; Ex Parte Spendiff: In Re Candida Footwear Manufacturers (Ltd) Pty; Ex Parte Spendiff: In Re Jerseytex (Pty) Ltd* 1988 1 SA 616 (D) 623E.

59 See Copp 2001 *JCLS* 12-19, who argues that achieving fairness is something of an art in company law – a concept of balancing rights.

60 Kilian and Du Plessis 2005 *TSAR* 48.

shares,[61] the total cash inflow equals R6 400. The average cash inflow is thus calculated at R2 133 per year, or 42,6% (R2 133 ÷ R5 000), which will be the percentage damages claimable when the company fails to declare any dividends for the following year.[62] An alternative would be to calculate the damages based on a discount factor/value. Such a calculation reduces the previous years of dividend payments to the initial investment of R5 000 in order to indicate the percentage of the dividends payable on such an initial investment.[63]

Damages and return on equity (ROE): According to this suggested method, the growth rate for a particular company is calculated by multiplying its retained turnover by the ROE ratio. If a company is able to retain 75% of its turnover, and the ROE is 15%, the expected growth rate for dividends would be 11,25% (15 x 0,75), which would represent the growth or increase in the previous dividend payment.[64]

Damages and history of no dividends declared: Where a company has a history of not declaring dividends, the solution is simply to compare the book value per share with that of previous financial years. If, for example, the company retains 100% of its earnings (or profits) because no dividends were declared, the book value or return on equity could be calculated as follows:

	1999	2000
Net profit retained	R0	R15
Number of shares	100	100
Increase on book value per share	R100	R115 (15% increase)
Book value per share calculated	R1 (100 ÷ 100)	R1,15 (115 ÷ 100) (15% increase)

61 See *Ex Parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W) 282, where it is stated that "[t]he prospect of a future stream of dividends may serve to enhance the capital value of … shares".

62 See Delport *Verkryging van Kapitaal* 190.

63 See Delport *Verkryging van Kapitaal* 191; Kilian 2007 *THRHR* 391.

64 See Smart, Megginson and Gitman *Corporate Finance* 155. Also see Orts 1998 *Yale L & Pol'y Rev* 266, 307, 308.

As no dividends were paid to the shareholders, company equity has increased by 15%. Of course, instead of paying dividends the company could buy back its shares at a 15% higher value. The shares would be repurchased at their book value per share, and the 15% increase on the book value would be added value or, in other words, profits that could be used to pay dividends.[65]

4.3 When courts are faced with various methods to calculate damages

One could argue that shareholders always have the option of selling their shares for a profit instead of waiting to receive a dividend.[66] However, even though this may be an alternative way to receive cash in the commercial world, what if the shareholder is not willing to sell?

In line with section 158(a) of the *Companies Act* of 2008, which deals with the development of the law, considering or identifying alternatives is important, as these enable better judgment when, for example, courts have to decide[67] on the remedies available to shareholders to challenge the company's discretion not to recommend dividends, or on how to calculate dividends as damages.[68] The difficulty in applying these various alternatives in practice simply is that courts may be confused as to how the correct formula for calculating dividends should be identified or applied.[69] In this regard, Arnold provides the following clarification:

> [G]oing through a rigorous process of valuation [dividend] is more important than arriving at an answer. It is the understanding of the assumptions [of alternatives] and an appreciation of the nature of the inputs to the process that give insight, not a single number at the end.[70]

It appears that Stegmann J in *Ex Parte Lebowa Development Corporation Ltd*[71] had in mind a similar explanation when he was confronted with

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65 See Smart, Megginson and Gitman *Corporate Finance* 156. Also see *Ex Parte Natal Coal Exploration Co Ltd* 1985 4 SA 279 (W) 282: "A shareholder is a participant in a risk venture embarked on with a view to making profits. He has the prospect that if profits are made, a dividend may be paid."

66 Pretorius *et al Hahlo's South African Company Law* 144, 146.

67 See Smart, Megginson and Gitman *Corporate Finance* 381, where the authors focus on the definitions of "rational" efficiency.

68 The heading of s 158 is in fact "Remedies to promote purpose of the Act".

69 See Kilian 2007 *THRHR* 391.

70 Arnold *Handbook of Corporate Finance* 345.

71 *Ex Parte Lebowa Development Corporation Ltd* 1989 3 SA 71 (TPD) 97G-I, which followed on the dictum in *Ex Parte Strydom: In Re Central Plumbing Works (Natal) (Pty) Ltd; Ex Parte Spendiff: In Re Candida Footwear Manufacturers (Ltd) Pty; Ex Parte Spendiff: In Re Jerseytex (Pty) Ltd* 1988 1 SA 616 (D) 623E.

different formulas to calculate the true solvency position of a company. He held that "the suggestion that one test [solvency test][72] is true and the other not, is unwarranted".[73] A court should therefore analyse all available information to make an informed or rational judgment concerning a suitable method of awarding damages. It should be noted that a court would not grant specific performance where a plaintiff could be equally or adequately compensated by damages. However, it should also be noted that in the event of the non-delivery of purchased shares a court should grant specific performance instead of damages. The reason is simply that a favourable economic reality may be achieved by ordering damages instead of an order for specific performance. For example, if a shareholder purchased 171 000 shares and received delivery of only 107 000 shares, the company who failed to deliver 64 000 shares would increase its earnings per share ratio, as these shares would not be taken into account when calculating earnings per share.[74]

5 A final consideration: The disputability of the decision by the general meeting of shareholders

It may happen that the board of directors recommends or authorises a dividend, but the general meeting of shareholders decides not to declare the dividend.[75] It is somewhat problematic to establish when such a decision taken by the general meeting of shareholders is invalid in South Africa.[76] Van Rooyen argues that the decision can be challenged by the minority

72 Own insertion.

73 *Ex Parte Lebowa Development Corporation Ltd* 1989 3 SA 71 (TPD) 97G-I. Also see *Ex Parte Buttner Bros* 1930 CPD 138.

74 *Benson v SA Mutual Life Assurance Society* 1986 1 SA 776 (A). See Kilian and Snyman-Van Deventer 2014 *PER* 2636.

75 See Cassim *Practitioner's Guide* 116.

76 See Van Rooyen 1989 *TSAR* 603, who argues for an objective test to decide whether the decision taken by the general meeting of shareholders is valid or void. Also see Hoffnagle and Butler 1972 *Conn L Rev* 707; Pretorius *et al Hahlo's South African Company Law* 207.

shareholders of the company,[77] and that the test to challenge it should take the form of an objective enquiry.[78]

This approach is *sui generis*, as the doctrine of proper purpose relates only to company directors' duties and not to shareholders' duties as such. To support Van Rooyen's argument, section 163(1) allows for minority shareholders to challenge the general meeting's decision not to declare any dividends.[79]

Nevertheless, the following example illustrates when such a decision by the general meeting of shareholders will be sound and valid, and thus difficult to challenge objectively:

Extract from the income statement

	2003	**2002**
Top line	14 669	23 822
Net profit	-575	1 317

Extract from the cash flow statement

	Beginning	**End**
2003	16 607	9 401

77 Van Rooyen 1989 *TSAR* 605: "Lede mag in beginsel stem soos hulle wil en hul eie belange in ag neem by die uitbring van hulle stemme, maar daar moet rekening gehou word met die feit dat die eindresultaat van 'n stemming ... tersyde gestel kan word indien dit nie ... in belang van die maatskappy aangemerk kan word nie." [Members may in principle vote as they wish and consider their own interests in casting their votes, but it must be kept in mind that the end result of a vote may be set aside if it cannot be said to be in the interest of the company.]. Also see Koh 2005 *JCLS* 363; Vliet 1949 *Okla L Rev* 1-37. "One of the major dangers involved is that of minority control in the sense that the directors seldom own more than a small fraction, if any, of the voting shares in their individual capacities and therefore, being unrestrained by the responsibilities of beneficial ownership, may act other than in the best interest of those whom they represent."

78 Van Rooyen 1989 *TSAR* 605, arguing for a "reasonable person" test.

79 Section 163 deals with relief from oppressive or prejudicial company conduct.

Extract from the balance sheet

	2003	**2002**
Total assets	315 703	273 784

An analysis of the above leads to the following conclusions: Although the total assets of the company increased from 2002 to 2003, the same cannot be said for the net profit or cash in hand. Therefore, the positive end result in total assets creates an illusion that the company is profitable. The net profit of the company, however, decreased in 2003, which may indicate that either the cost of the capital employed by the company was very high[80] or the assets of the company could not produce a sufficient turnover to exceed the previous year's turnover.[81] To pay dividends under such circumstances would clearly be detrimental to the company, in which case the shareholders may rescind dividend payments.[82] Although section 163(2)(j) is a statutory remedy for relief against the oppressive conduct of companies, it is clear from the example above that the company is unprofitable and should not compensate shareholders for any undeclared dividends. The decision of the general meeting of shareholders to refuse to declare dividends may be an indication of oppressive conduct in terms of section 163(1), and relief should be granted only if the financial position of the company is favourable. On the other hand, section 163(2)(h) allows the court to change/vary the constitution to rectify any oppressive conduct. In the *Sumiseki Materials* case the shareholder successfully argued relief against the oppressive conduct of the company, and as a result the court varied the constitution to give effect to compensation for the unpaid dividends.[83]

6 Conclusion

80 See Varallo and Finkelstein 1992 *Bus Law* 239, who argue that perhaps no area has received less attention than the law pertaining to the governance of a troubled company. Also refer to Tomasic 1995 *Canberra L Rev*158.

81 See Pretorius *et al Hahlo's South African Company Law* 144-146, who explain the meaning of "profit".

82 See Rider 1979 *CLJ* 148, 150 for an explanation of the managerial functions of the general meeting of shareholders in general. Also see Tomasic 1995 *Canberra L Rev* 158.

83 Alevras and Du Plessis 2014 *C&SLJ* 312.

Orthodox company law principles dictate that dividends are based on the board's discretion, which means that a claim for damages where dividends remain unpaid may seem inconceivable. However, this article has indicated that South African courts may draw some valuable lessons from the reasoning applied in *Oxford Legal Group* and *Sumiseki Materials* to develop South African company law to cater for circumstances where a company board's discretion could be validly rejected to claim damages in the event of an unpaid dividend, even where a shareholder's right to a dividend is not explicitly regulated.[84] Having made the case for damages, this study has also proposed certain practical alternatives for calculating the amount of such damages, knowing that to recognise and identify alternatives can only assist in arriving at a more suitable solution than the current South African position of not granting damages at all.[85]

Facilitating this development of the common law will not only be in keeping with the spirit of section 158(a) of the 2008 *Companies Act*, but will also be fairer towards those getting onto the "merry-go-round", by balancing contractual rights with discretionary power so as to give business efficacy to dividends.[86]

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84 See Kilian and Du Plessis 2005 *TSAR* 48.
85 See Snyman *Remedies ter Beskikking* 20.
86 Also see s 7(i) of *Companies Act* 2008.

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List of Abbrevations

ABAJ	American Bar Association Journal
Bus Law	Business Lawyer
C&SLJ	Companies and Securities Law Journal
Canberra L Rev	Canberra Law Review
CLJ	Cambridge Law Journal
Conn L Rev	Connecticut Law Review

Denning LJ	Denning Law Journal
Duke LJ	Duke Law Journal
Harv L Rev	Harvard Law Review
HKLJ	Hong Kong Law Journal
J Leg Ed	Journal of Legal Education
JLS	Journal of Legal Studies
JCLS	Journal of Corporate Law Studies
JLS	Journal of Legal Studies
Mod Bus L	Modern Business Law
MUJLT	Masaryk University Journal of Law and Technology
Okla L Rev	Oklahoma Law Review
PER	Potchefstroom Elektroniese Regstydskrif
ROE	return on equity
ROI	return on investment
SALJ	South African Law Journal
SAMLJ	South African Mercantile Law Journal
Stetson L Rev	Stetson Law Review
THRHR	Tydskrif vir die Hedendaagse Romeins-Hollandse Reg
TSAR	Tydskrif vir die Suid-Afrikaanse Reg
U Det LJ	University of Detroit Law Journal
U.Pa L Rev	University of Pennsylvania Law Review
UNSWLJ	University of New South Wales Law Journal

Vill L Rev	Villanova Law Review
Yale L & Pol'y Rev	Yale Law and Policy Review