CML3010 ADVANCED COMPANY LAW

The European Law Students' Association

MALTA

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I. Company Law in the Context of the Wider Maltese Economy

Malta, although a small country, is still fully exposed to the risks of the global economic context. We must recognise the fact that Malta has managed to weather recent upheavals remarkably well. This success is by and large attributed to the fact that Malta's economy is diversified, despite its limitations, with the result that a downturn in any one sector is compensated for by continued strong performance in other areas. It is also pertinent to point out that although the country is well known as a tourist destination, the manufacturing industry still has an important role to play. However, there have been significant setbacks to the growth of the Maltese economy, such as the COVID-19 pandemic and Malta's inclusion on the FATF grey list. There have been a number of attempts to try to increase Malta's attractiveness to potential investors, such as in the gaming and blockchain sectors, although the latter does not appear to have had the immediate impact which was foreseen. The Maltese economy is always trying to attract investors but can only do so with a corporate structure strong enough. Together with these initiatives to attract foreign investment, there has been an increased call by the EU for added accountability and transparency of companies with respect to ESG, and companies are nowadays encouraged to continue to spend significant time and effort in identifying how to constantly capture meaningful and reliable non-financial data to share with their stakeholders. Digital solutions could offer them support in this challenge. In fact, one of the most important initiatives ongoing relates to what is referred to as Digital Malta, in line with the EU requirements.

We have seen that although we understand the notion of the sole trader, which still holds an important place in the Maltese business sector, we now know that trade or business can be carried out by individuals, but more importantly by commercial partnerships. It has been proven that this idea of having a corporate form developed with the progress of society and they have been increasingly part of how businesses operate in Malta. There are in the region of 100,000 companies registered in Malta at present. Without a shadow of a doubt, in the Maltese economic experience, the LLC has by far been the most popular and the most important form of business organisation, owing to its flexibility. A company can be used for simple as well as complex transactions and it has been proven that it has served business growth well.

This must be balanced with the reality that unfortunately this corporate legal fiction must be protected against fraudsters, speculators, tax evaders, and money launderers. The company was and still is an extraordinary invention. It is a flexible, relatively simple, and very resilient device. The original company was typically a large, hugely expensive, and risky enterprise created in order to construct vessels for expeditions or the constriction of railroads. Today, it is used as a vehicle for less ambitious objectives and can undertake any business whatsoever, even for single

transactions or to hold an asset. Nonetheless, it has proven to be a force for good and indeed it is considered to be a motor of the Maltese economy. It is within this context that we are to understand the following lectures on company law. one must be sensitive to the underlying objective of corporate legislation that strives to fulfil the objective of allowing business to be carried on within sensible parameters whilst controlling and trying to prevent excessive behaviour and abuse of the corporate form.

Small and Medium Enterprises (SMEs) are by and large the most popular size of company prevalent in Malta, and it is for this reason that one must be extra careful not to overburden them with requirements. In recent years Malta's economy has expanded rapidly, and this is a reflection of the fact that it has shifted towards an export-oriented market. Having said this, this transformation left untouched a longstanding characteristic of the Maltese economy, namely its reliance on SMEs. Whilst there has been a tendency to emphasis the contribution of large projects and new sectors, official statistics suggest that SMEs accounted for a significant share of growth observed in recent years, with SMEs having generated nearly two-thirds of all growth in value, and half of the rise in employment. This is a healthy development as growing dependence on many SMEs is making the Maltese economy more diversified and therefore less susceptible to shocks. In order to ensure that this SME sector remains viable and strong, one can note that for this trend to continue, it is important that SMEs have good access to finance and skilled labour, and be sustained by an adequate infrastructure, as per the Central Bank. This report also noted that particular attention should be given to small economic operators which aim to export their goods and services. Malta's open economy shall benefit immediately if less importance is given to local consumption whilst export activities are fully supported by government. The difficulties faced by family-owned operations were highlighted. These should be encouraged to make use of favourable legal concessions to ensure that the transfer of ownership from one generation to another promotes continuity and stability. There has been a trend that problems arise with respect to the succession of a family business and many children are introduced to the company's management.

The gaming sector represents nearly 13% of Malta's GDP. This industry has recently flourished as many gaming companies find Malta attractive to operate in. This is owing to Malta's corporate tax system. The fact that Malta is an EU MS with the Euro, coupled with its geographical position and diverse, multilingual workforce, makes it an attractive location for gaming companies. Malta offers what some observers recognise as the best ecosystem for such companies, offering a good combination of legislation and infrastructure to support them. It remains to be seen how this sector shall develop, but it nevertheless represents an important building block of the Maltese economy. Other areas where Malta has also sought to increase its visibility include blockchain, data mining, AI, the internet of things, and predictive analytics.

Another trend increasing at a fast pace is the idea of corporate governance. Essentially, what this refers to is a system that goes beyond the actual shareholders and members of the company to embrace within it a number of stakeholders, taking into account what a company has to offer to society at large. The rules on corporate governance include within it a system of practices and processes by which a firm is directed and controlled. Directors, for example, are not merely there to observe their

duties as prescribed in the Companies Act. Not only should they respect what is stated in the M&A, but additional obligations are incumbent on them to adhere to these rules of corporate governance. This involves the balancing of the interests of a company's many stakeholders, such as shareholders, senior management executives, customers, suppliers, the government, and the community. This is what makes a company more visible within the community. If a company were to disregard corporate governance, it risks damaging its international reputation, which would imply a possible downward trend in its customers. An oft-cited example of corporate misgovernance is the Volkswagen emissions scandal.

II. The Registrar of Companies – A Changing Role

In Malta, the company is the most popular form of doing business, with there being over one-hundred and twenty-thousand registered at the MBR. The Registrar plays a very important role in the Companies Act. The role of the Registrar is mainly that of registering documents. It is the process of making things available to the public which did not always exist, making it a huge move towards transparency and disclosure, which are massively important in most spheres of law. The original companies were large entities called joint stock companies which financed shipping expeditions with tremendous risk. Originally, businessmen in the early 17th century began entering into contracts to create enterprises and give themselves limited liability to protect their personal assets. However, there was no central place where one could go verify information about the company. There began growing the demand for a visible structure with a governing body for investors and shareholders with clearly stated objects which eventually, after a highly controversial and long process, took the form of the company. Originally, companies had to be established by royal charter, until there was a process of democratisation and companies were made available to everyone. Thus, for the purposes of predictability and transparency, and to make companies more credible, the company's legal personality was created to allow it to outlive its owners and directors. Limited liability came later but in the interim lawyers did so through private contract. However, with the involvement of third parties these agreements had no bearing. Today, we take limited liability for granted as LLCs have always been around, but at the time they were fiercely contested due to fears of abuse.

At one point in the early 18th Century in England, where the culture was based on a laissez-faire attitude to trade self-regulation, there was a tension between what should have been regulated and to what extent. Until it was decided that a public register should be created, which was countered by an overall distrust of government involvement in business. Here, therefore, we see a tension between government intervention and non-intervention. However, it was felt that the pros outweigh the cons because it would create a process whereby people can have confidence in companies and be able to learn who was behind them and what they were doing. Therefore, for this to be implemented there was the need for the creation of a separate government department to be staffed by civil servants. This was developed by a movement to increase standardisation in the drafting of companies' memoranda and articles of association to make the incorporation process quicker and avoid bureaucracy. Thus, the British form of incorporation has always been an especially expeditious one. They also produced model memoranda and articles of association that would be applicable if the company did not draft their own. As the desire for transparency increased so did the amount of disclosure that was required, including the filing of audited accounts and the creation of the auditing profession, which gave investors added confidence. These documents were placed with the government official known as the registrar of companies.

The office of the Registrar itself, then known as the Registrar of Joint Stock Companies, was created by the Joint Stock Act of 1844. When these laws began to be implemented businessmen and lawyers realised that companies could be created for smaller purposes as well as for large ones. The Registry continued to grow as a result and became a place for the public to access company information. The Registrar

was empowered to register companies by a two-stage process. The first, provisional, stage cost £5 (equivalent to £532 in 2021) and did not confer corporate status, which arose after completing the second stage for another £5. However, there was still no limited liability and company members could still be held responsible for unlimited losses by the company.[2] Limited liability was subsequently introduced by the Limited Liability Act 1855. The system of registration was revised by the Joint Stock Companies Act 1856. The aim of the act was to place business and economy on a surer foundation and to increase public confidence in the honesty of business.

Company law is part of public law, although there are some elements of private law. The Registrar represents the State in the incorporation process by issuing a certificate of incorporation, granting the company its own artificial legal personality and patrimony to be recognised by the State. Company law has two main objects: one, facultative and enabling (allows people to establish companies); two, controlling and regulating (prohibitions). The MBR offers the public relevant corporate information and transparency. The inclination of the public is for added regulation and State intervention, especially when large companies fail, or corporate misconduct is exposed. Therefore, the controlling aspect keeps growing.

The Commercial Partnerships Ordinance 1964 is the predecessor to the Companies Act 1995. The CPO was referred to as the Registrar of Partnerships as we remained in the Civil Law mindset of referring to the LLC as a form of commercial partnership. This meant that a company needed at least two shareholders to be legally incorporated. The Department was known for its efficiency and for being exceptionally lucrative in terms of fees. The powers of the Registrar under the Ordinance were limited, although it already had the role of ensuring compliance therewith, chasing companies to fill their returns and the proper forms. It was not the idea of the legislator to have the Registrar function as a regulator for commercial partnerships. The typical regulator, like the MFSA, holds the key to a particular economic sector, i.e., if one wants to open a bank, one needs to obtain a license from the Malta Financial Services Authority. The regulator must be able to prohibit individuals or entities from entering into its field of jurisprudence for it to be effective. A registrar, on the other hand, cannot prohibit anyone from registering a company if the requisite documents are all in order and meet the corresponding requirements. Furthermore, the registrar works across all economic sectors and a license therefrom is insufficient to enter a chosen field if a specific license is required. The role of the regulator is becoming increasingly powerful as the Maltese mentality is always in favour of added regulation, as opposed to the English laissez-faire culture. Self-regulation, as opposed to deregulation, involves the creation of private bodies issued with government licenses to regulate certain economic sectors or professions. However, in most cases this does not work.

The Co-operatives Board is both a registrar and a regulator. One cannot establish a co-operative without the approval of the board which in turn also regulates the way in which they are run. Therefore, we have the intervention of the government in both a registrar and regulatory function, as the head of the Board is appointed by the Minister for Finance. This is indicative of the general trend towards a blurring of the functions of the regulator and registrar in particular entities. The MBR, as the result of EU Directives and increased regulation, has been given more and more regulatory

powers, making the modern MBR very different from the Registrar of two decades ago.

The Registrar's function evolved under the Companies Act 1995 which was promulgated *"To regulate, in place of the Commercial Partnerships Ordinance, limited liability companies and other commercial partnerships".* In 1994 Malta changed its financial services legislation, including the introduction of the first Acts against market abuse. It was then felt that a new Companies Act would be needed to indicate the shift from an offshore jurisdiction to a financial services capital as the CPO was felt to be anachronistic. KPMG of London was engaged to draft the legislation and as a result the Act largely reflects English Company Law. The elements of control of the Registrar were largely extended as a result. However, each and every section was changed, and so English law is not directly applicable. Some parts, such as that regulating the rights of the minority, were adapted from other foreign laws, in this case that of New Zealand. A transitional Act was passed in 1994 to introduce the ability to have share capital in foreign currency, referring to an Act which did not exist at the time.

Article 400 of the Companies Act states:

> **400.** (1) *The Minister shall appoint a senior official of the Agency to be Registrar of Companies and other Commercial Partnerships, who shall be designated "Registrar of Companies", and may appoint persons to assist such Registrar, conferring on any such persons all or any of the powers of the Registrar under this Act or any other law.*
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> (2) *Without prejudice to the provisions of sub-article (1), the Registrar may authorise in writing any person serving with the office of the Registrar to perform any of the functions assigned to the Registrar under this Act or any other law.*

Previously the Minister would appoint a senior official of the MFSA because in 1997 until 2016 the Registry of Companies was attached to the financial regulator. This was the result of a decision to have the MFSA convert all documents electronically in return for the Registry to be amalgamated into the regulator. Having direct access to the information of every limited liability company registered in Malta was incredibly useful, as well as to the registrar revenue stream, was very beneficial to the regulator. This also allowed the regulator to better cooperate with foreign counterparts, such as the Securities and Exchange Commission (SEC) in the United States or the Financial Conduct Authority (FCA) in the United Kingdom. This was changed by Act V of 2020 where the Minister, instead of appointing a senior official of the MFSA, was tasked with appointing a senior official of the agency. In Malta, it is becoming increasingly popular for Ministers of the State to create public agencies, in this case the Malta Business Registry.

The government, as the result of EU Directives, has created the Insolvency and Receivership Service which now forms of the MBR, but is its own regulator for the liquidator profession. However, it has been criticised as making the liquidation process more costly. Apart from the amendments to the Insolvency Act, if one considers the Companies Act today, the role of the Registrar is continuously growing.

Article 401 regulates the main functions of the Registrar, whose powers have increased exponentially with the introduced of additional anti-money laundering procedures, including added transparency surrounding the ultimate beneficiary owner (UBO), new powers of investigation, new powers to dismiss company directors, etc. Today, the Registrar's role as a regulator is more pronounced, partially as the result of added powers given in the wake of the FATF grey-listing scandal. Company Law was one of the first chapters of the EU's *acquis communautaire* to be transposed by the legislature to boost Malta's chances as a candidate State.

As part of its duties to ensure compliance with the Act, the Registrar has the power to assess applications for the incorporation put only has the ability to assess whether the requirements are met, not whether the company's accounts indicate success. This is deemed to be the role of the auditor, which deviates from that in England as, locally, companies' audited accounts are required to be signed by individual persons, not the firms they work for. The notion of the Registrar has definitely been taken from English law and practice, as is the case with most Commonwealth States.

III. Corporate Governance

Within a company structure, the entity responsible for the company's governance is the board of directors and, as a general rule, the board owes its duties to the company *per se*, which, in turn, is owned by its shareholders/members. The duties owed by directors are fiduciary and the main sources thereof are the memorandum and articles of association, and the Companies Act. With respect to the minimum threshold for the number of directors, there is a difference between public and private companies. We shall see that with respect to larger companies there are additional duties which emanate from corporate governance and the MFSA has issued a corporate governance code which includes them. There is some resistance with respect to smaller companies because it is argued that these additional obligations would have a negative effect on their performance, making them too costly to be run effectively.

Corporate governance is not uniformly defined, however. Professor Muscat states that *"although there is no strict definition of the term corporate governance, its wider spectrum has been said to engulf practically anything that concerns the manner in which companies, listed or not, are governed, and includes* inter alia*, directors' duties, minority rights, and creditor protection".* Essentially, what Profs Muscat provides us with are the basic requisites for corporate governance. In coming to a definition of corporate governance we must trace back its origins. By and large, it is accepted that the origins of corporate governance date back to 1992 where it was mentioned in Lord Cadbury's report. The definition provides in that report is widely recognised as the origins of this concept, which states that corporate governance is *"the system by which companies are directed and controlled, whilst corporate structures and mechanisms are the result of the cultural context in which entities exist and operate".*

Here, we have a reflection of the basic paradigm in the organs of the company between the board of directors and the shareholders. Along the years there has been some fine tuning in the said definition. In a subsequent report commissioned by the OECD, the *Millstein* report, two possible definitions were given, the narrow version and a wider one. In the former, corporate governance is defined as *"the relationship between managers, directors, and shareholders"*, also encompassing the relationship between the corporation, stakeholders, and society. Thus, the duties of directors were no longer limited to the company and its shareholders, but instead they also some duties to stakeholders and society at large. In the latter, wider, definition, Millstein states that *"corporate governance encompasses a combination of laws, regulations, listing rules, and voluntary private sector practices".* It is also acknowledged that corporate governance primarily concerns the manner of how the corporation employs the assets provided by the investors and ensuring that these are put to profitable use. In a general sense, this OECD report provides the framework for corporate governance which has, in some form or another, been adopted globally.

If one attempts to apply the general principle to the domestic reality, there is a debate as to whether this concept of corporate governance should be a self-regulated process. The other extreme would be to consider whether all companies should be obliged to comply with their duties towards a regulated corporate governance regime. A third possibility would be to have a model based on a mix of both, i.e., a combination of self-regulation and imposed obligations. The reason as to why there is a resistance

to having these obligations being compulsory, is because the size of most companies renders the implication of these mandatory obligations impracticable, particularly where the number of directors in small-sized companies is not more than two or three. Therefore, it would be the same directors occupying the audit committee, the remuneration committee, the nominations committee, be chairman and CEO, as well as assess their performance.

The Volkswagen emissions scandal is referred to as the classic example of corporate misgovernance. Dr David Fabri states that “this example demonstrates how one of the world’s best companies almost ended up like ENRON”, with penalties and costs in the USA having risen to twenty-five billion dollars. By contrast, there was a relative inaction by authorities in Malta and in Europe in general. In this case, it would have been expected for the Malta Consumer Protection to take some action to see whether there were any action consumers could have taken to be reimbursed for damages suffered. In this case, in order to enter the European and American markets, cars must pass an emissions test with VW having programmed their diesel cars to beat these tests. John Armor from the University of Oxford states that what was astonishing about VW’s behaviour was the scale and method of their deceit. The technology used entailed a trade off against fuel economy and performance. When the VW engineers and programmers had decided to manage, by introducing two distinct driving modes, a bets behaviour mode which complied with tests and another for all other circumstances, they designed a system intelligent enough to defeat the highly predictable tests automatically. However, in reality, the cars emitted up to forty times more nitrous oxide during the normal circumstances. It is not clear how and why they came to do this, but what is certain is that there were a number of breaches at different levels of the company.

As to why risk-averse individuals amongst management might have failed to investigate potential smoking-guns, one could easily identify five significant failures by VW: first and most notably customer abuse when VW manifested failure of integrity and honesty in dealing with customers because most people choose to buy a VW as distinct from any other car brand because it offers certain assurance of a certain German quality, and by tampering with emissions it failed to do so. Second, VW undertook deceptive advertising by promoting their cars as in line with emissions standards. Thirdly, VW tricked regulators and caused massive environmental harm. Fourth, there was failure in whistleblowing procedures. Fifth, failures in corporate governance as it was extremely clear that there was bad board composition and group strategy.

It has been shown that in the aftermath of this scandal various changes in the management structure and composition of the board were introduced. It was recognised that in the case of VW there were too many directors of the same or similar background and experience. When there is a lack of diversity of experience and a skill there would not be the necessary checks and balances to ensure that there are no breaches in good governance. If one had to continue with this example, in order to regain its international reputation, the company introduced a number of significant remedial measures that included the following: first, within the board composition of VW a minimum number of international and female directors were introduced; second,

a new ombudsman scheme was made part of the company's governance structure; third, new internal and external whistleblowing mechanisms were introduced; fourth, a number of new mechanisms of oversight and supervision was made part of the technical department overseeing diesel engines; fifth, two rather novel ideas within governance were also introduced, essentially the appointment of a new director whose main task was to oversee the ethical levels across the board and production of the company and to ensure that integrity levels were preserved; sixth, a new age limit was introduced.

As things stand today, there are different levels of corporate governance depending on the size of the company, as LLCs in and of themselves are governed by the Companies Act and the corporate statute. But with respect to listed and regulated companies, apart from the requirements that emanate from the CA and the M&A, there are a number of special laws and, more importantly, a number of rules and principles issued by the MFSA.

The Sources of Corporate Governance

The principal source of corporate governance, the Companies Act offers specific sections dealing with the division of authority between the board of directors on the one hand and the general meeting of shareholders on the other. Furthermore, directors' duties and accountability also find their source in the Companies Act together with shareholder redress mechanisms and disclosure and transparency requirements. These requirements of transparency are tangibly manifested in the form of annual financial reporting duties and shareholder information rights.

The M&A is linked to the Companies Act and recognised as an important source under Maltese law. whilst the memorandum describes the essential features of a company targeted at the outside world, the articles deal with the internal relationship of a company with its members and the relationship between members themselves, and it is recognised as being an important tool to supplement the CG provisions found in the CA.

Together with these basic documents, along the years the MFSA has issued a number of guidelines and, in so doing, it has put as part and parcel of Maltese law on certain companies, certain requirements that emanate from our EU obligations, and one will note that the latest compendium of rules dealing with CG was issued in 2022, i.e., the corporate governance code which is applicable across all sectors to all unlisted entities authorised by the MFSA.

In reality, we have a combination of self-assessment and mandatory obligations, but the elements of supervision and checks and balances remain a constant theme throughout. It cannot be permitted that one rogue director could destabilise an entire company. Another important aspect is that of internal and external checks, such that there must be a complementary set of procedures ensuring that a company is governed in a good and correct manner. The MFSA has issued but a CG Code for authorised entities and guidelines for cultural entities. In the former's preamble, the following is stated:

"Corporate governance: "the system by which all companies are directed and controlled", 1 or more widely "the social, legal, and economic process through which companies function and are held accountable". It is strategically crucial to ensure that all Authorised Entities operate transparently, efficiently, and effectively, and achieve a judicious balance between their own interest and the various constituents in the environment in which they operate. Corporate governance ensures the Board of Directors and management are discharging their functions effectively when it comes to building and satisfying stakeholders' confidence.

"It is the responsibility of the Board to ensure there is good corporate governance, by setting culture, managing stakeholders, and ensuring that adequate systems for control and oversight of the business are in place, thus delivering satisfactory outcomes.

"Good corporate governance fosters mutual trust with stakeholders, including customers, employees, intermediaries, and the general public, as well as with the jurisdiction as a whole. It is conducive to value creation for all stakeholders, ensuring the financial soundness of firms, the protection of investors, as well as the integrity of the market. Conversely, governance shortcomings may lie at the heart of failure in financial services entities, whether that is a failure to treat customers fairly, a failure to ensure appropriate financial crime and other regulatory compliance/controls, or failure to abide with good business practices. This may in turn have repercussions on the business sector in which the entity operates and, consequently, on the economy in general and on the reputation of the jurisdiction. Furthermore, good governance is also considered a key enabler for entities to generate business benefits, shareholder value and higher trust, enhancing their strategic competitive advantage.

"Internal governance structure and related arrangements are considered as key indicators of the compliance culture and performance readiness of Authorised Entities. In this respect, as outlined in its Strategic Update published in 2021 and the Supervisory Priorities for 2022, the Malta Financial Services Authority ('MFSA' or the 'Authority') places a lot of emphasis on ensuring that Boards of Authorised Entities adopt a governance system that delivers satisfactory and high-quality outcomes.

"In this light, the Authority is issuing this Corporate Governance Code (Code), applicable cross-sectorally to all unlisted entities authorised by the MFSA, inter alia to:

- Set out best practice in corporate governance for entities falling within the MFSA's regulatory remit.
- Enhance governance structures, improve relations, and strengthen trust with stakeholders.
- Ensure effective operation of Authorised Entities' Boards and management.

- Assist Directors and Senior Management to fulfil their duties, including in advancing the growth and development of the entities they are entrusted to direct and manage.
- Ensure that Authorised Entities have adequate and effective internal controls, and procedures to discharge their responsibilities and monitor outcomes.
- Enhance stakeholder and public confidence in the financial services sector in general.
- Assist entities to put in place improved governance standards to achieve enhanced resilience and sustainable operations going forward, as well as ensuring ethical behaviour.

> "This Corporate Governance Code shall not apply to Listed Entities falling within the scope of the Capital Market Rules, and neither shall it apply to Authorised Entities which are also Listed Entities falling within the scope of the Capital Markets Rules, given that these contain more specific provisions in this regard, including a Code of Principles of Good Corporate Governance. This Code shall also not apply to Authorised Persons who are natural persons.
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> "In structuring the revised corporate governance framework, the Authority conducted a public consultation exercise, and the views put forward by stakeholders were taken into consideration in devising this document. Further to such consultation, and best practices set by international bodies such as the European Commission and the OECD, the resultant framework shall comprise of a combination of elements of 'soft law' mechanisms, such as this Code and other sectoral initiatives that may be implemented, together with mandatory provisions incorporated in the respective regulatory frameworks.
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> "The Code provides a set of principles, complemented by supporting provisions, which are to be applied on a 'best-effort basis'. These are organised into four main sections, as follows: [i] the Effective Board; [ii] Internal Controls; [iii] Stakeholder Engagement; and [iv] Corporate Culture, CSR and ESG. The Authority believes that this approach ensures efficacy and proportionality in the Code's application and is in line with corporate governance policies and approaches advocated by international bodies such as the European Commission and OECD.
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> "These principles are designed to enhance the legal, institutional, and regulatory framework for good governance in the Maltese financial services sector. They thus complement the current provisions already in force in the legal and regulatory framework. Entities should endeavour to adopt these principles, thereby fostering an environment of trust, transparency, and accountability necessary for long-term investment, financial stability, and business integrity".

Environmental, social, and governance activities (ESG) is not something new to Malta, but, to the contrary, Malta was a forerunner with respect to the promotion of the environment in the interest of the common heritage of mankind. In effect, it was the

Maltese Ambassador to the UN Armond Pardo, who in 1967 made a recommendation to the UN so that the seabed, ocean floor, and subsoil be recognised as a common heritage of mankind to be used for peaceful purposes and for the exclusive benefit of humanity, thus preventing the unsustainable use or misappropriation of resources and minerals. At the time of its proposal, unfortunately, it was rejected, but it went on to form an integral part of the UN Framework Convention on Climate Change and the Kyoto Protocol. The notion of sustainable development is an integral part of world politics, especially in light of the UNSDG goals.

Thus, we see the idea of promoting sustainable development in light of the public at large, beyond simply for the protection and benefit of stakeholders. The EU, for its part, is on its way to implement the notion of sustainable corporate governance. A recent local initiative with respect to ESG is one by the Malta Stock Exchange wherein there was the listing of green bonds thereon that were aimed at giving a number of incentives to issuers that were seeking funds in order to finance green projects. In fact, projects that satisfied the criteria set out in the MSE green list that are in turn based on the international capital markets association green bonds principles, would be entitled to reduced listing fees. In order for investors to qualify for such benefits the projects which they seek to finance must have, *inter alia*, the following objectives:

1. Climate change mitigation,
2. Climate change adaption,
3. Pollution prevention,
4. The sustainable use of water and marine resources.

Furthermore, in the summer of 2022 thirteen local business formed an alliance to tackle ESG issues whose overriding ambition is to increase its membership to inspire change through its actions.

The Code of Principles of Good Corporate Governance

The Working Group on Corporate Governance was created by the Malta Stock Exchange to draft a code of corporate governance to be presented to the Council of the MSE in 2001. During its work, the Group identified three particular areas of corporate governance it felt needed to be addressed: first, the board and the directors; second, the remuneration of directors; third, the relations with stakeholders and the market. However, it was felt that the first group merited special attention and focus. The Code was published that same year and was completely revised in 2006, taking into account guidelines established by the Organisation for Economic Cooperation and Development. The Code is designed the complement the Companies Act and is aimed at listed companies but remains non-binding, urging them to *"adopt the principles s as to provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders"*, which it stated should:

1. Facilitate effective monitoring of a company thereby encouraging it to use resources more efficiently,
2. Provide more transparent governance structures and improved relations within the market which in turn should enhance market integrity and confidence,

3. Ensure proper transparency and disclosure of all dealings or transactions involving the board, any director, senior managers, or officers in a position of trust or other related party, and
4. Protect shareholders from the potential abuse of those entrusted with the direction and management of the company by the setting up of structures that improve accountability to them.

Professor Muscat describes most of the principles listed in the Code as self-evident, stating it is obvious that a company should be headed by *"an effective board"* or that no individual *"should have unfettered powers of decision"* or that the board *"should meet sufficiently regularly to discharge its duties effectively".* However, he highlighted the benefit of having a *"practical and salutary reminder of what constitutes good practice".* It is worth remembering at all times that the Code is not a legally binding instrument, and its adoption is not mandatary for companies that are not listed. To that end, where any matter of company law conflicts with the Code, it is the former that would take precedence. The Code is structured into twelve Principles; the following are a few of the most pertinent ones.

Principle I – The Board

Every listed company *"should be headed by an effective board, which should lead and control the company"*. The board should be composed of persons fit and proper to direct the business of the company, with fitness and probity requiring honesty, competency, and solvency. The supporting principles also declare that leadership can only come about if the directors, individually and collectively, are of the appropriate calibre, with the necessary skills and experience to contribute effectively to the decision-making process and that accordingly the directors should acquire a broad knowledge of the business of the company, be aware of and conversant with the statutory and regulatory requirements connected to the business of the company, allocate sufficient time to perform their responsibilities, and regularly attend meetings of the board.

The supporting principles require directors to:

1. Exercise prudent and effective controls which enable risk to be assessed and managed in order to achieve continued prosperity of the company,
2. Be accountable for all actions or non-actions arising from discussion and actions taken by them or their delegates,
3. Determine the company's strategic aims and the organisational structure,
4. Regularly review management performance and ensure that the company has the appropriate mix of financial and human resources to meet its objectives and improve the economic and commercial prosperity of the company,
5. Set the company's values and standards in order to enhance and safeguard the interests of shareholders and third parties,
6. Act with integrity and due diligence whilst discharging their duties in particular in the decision and policy-making processes of the company, and
7. Exercise accountability to shareholders and be responsible to relevant stakeholders.

The supporting principles also stated that the appointment of directors is within the jurisdiction of the shareholders and that the appointment process should be transparent and conducted at properly constituted general meetings where the views of the minority can be expressed.

Principle II – Chairman and Chief Executive
The Code differentiates between the roles of chairman of the board and chief executive officer so as not to concentrate authority and power in the hands of one individual, stating that there should be a *"clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business"* and that *"no one individual or small group of individuals should have unfettered powers of decision".* Therefore, the Code recommends that the posts be held by separate individuals. However, there this not to be the case the company should explain to the market and to its shareholders, by means of a company announcement, the reason for the decision to combine the two roles. The supporting principles also list out a number of responsibilities for the chairman, namely:

1. To lead the board and set its agenda,
2. To ensure that the directors receive precise, timely, and objective information so that they can take sound decisions and effectively monitor the performance of the company,
3. To ensure effective communication with shareholders, and
4. To encourage active engagement by all members of the board when considering complex or contentious issues.

Principles III – Non-Executive Directors
The Code states that the board *"should be composed of executive and a number of non-executive directors (including independent non-executives)"*, where the latter, through the use of committees, would oversee the board's supervisory function, whilst the former would oversee its management function. Furthermore, non-executive directors bring value in their own right by offering additional valuable experience and a different perspective, helping companies to focus on key issues of strategy, performance, resources, succession plans, and standards of conduct. Directors are exhorted to apply to his duties the necessary time and attention, and he should undertake to limit the number of any directorships held in other companies to such an extent that the proper performance of his duties is assured. To ensure independent and impartial judgement, independent directors should be free from any business, family, or other relationship with the company, its controlling shareholder, or the management of either, that could create a conflict of interest.

The supporting principles identify the following functions of non-executive directors:

1. Constructively challenging and helping to develop proposals on strategy,
2. Monitoring the reporting of performance,
3. Scrutinising the performance of management in meeting agreed goals and objectives, and

4. Satisfying themselves on the integrity of financial information and that financial controls and risk management systems are well established.

Whilst the appointment of directors to executive posts is within the board's power, it cannot in practice ensure the correct blend between executive and non-executive directors, as the supporting principles recommend, as the appointment of individuals to the board is squarely within the power of shareholders. Furthermore, a director may be unable or unwilling to accept an executive post for a number of reasons. Another conflict arising from this fact results from Principle III.I which states that the board *"should ensure that it is composed of members who, as a whole, have the required diversity of knowledge, judgement, and experience to properly complete their tasks".* It is not up to the board to police who the company's members appoint at general meetings.

Principle IV – The Responsibilities of the Board
The majority of sub-principles emanating from this Principle merely confirm elements of company law and none of the former depart from the latter.

Accountability
The Board is required to *"clearly define its level of power and ensure that it is known by all directors and the senior management of the company".* Delegation of any authority to the company's management should be clear and unequivocal. Directors should act responsibly, exercising independent and objective judgement with the highest degree of integrity, on a fully informed basis in good faith, with due diligence, and in the best interests of the company when effectively monitoring the implementation of strategy and policy by management. Another supporting principle exhorts the company to maintain an effective dialogue with stakeholders in the best interests of the company; a group that is not defined by the Code but is considered to include employees, suppliers, customers, and the wider community in which the company operates. However, it is worth noting that the interests of stakeholders are already legally protected by contractual and regulatory measures independently of the principles of corporate governance.

Monitoring
Supporting principles require the board to regularly:

1. Review and evaluate corporate strategy, major operational and financial plans, risk policy, and performance objectives, and
2. Monitor effectively corporate performance and the implementation of strategy and policy by management *"within the parameters of all relevant laws, regulations, and codes of best business practice".*

The board should understand and fully appreciate business risk issues and key performance indicators affecting the ability of the company to achieve its objectives. It shall also monitor the external environment for threats and risks to present and future operations opportunities, and assess any circumstances, whether actual or potential, that could expose the company or its directors to risk and take appropriate action. The

board also has a duty to ensure management similarly monitors the business environment and produces a quarterly report including its observations.

Strategy Formulation
As part of an ongoing process, the board is required to regularly review and evaluate corporate strategy; specifically evaluating the management's implementation of corporate strategy and financial objectives. The board should define in clear and concise terms the company's strategy, policies, management performance criteria, and business policies. These should be measurable in a precise and tangible manner.

Policy Development
The board is urged to recognise and support enterprise and innovation within the management of the company and examine how best to motivate management. It should establish an effective decision-making process in order to develop the company's business efficiently. It should also ensure that the company has appropriate policies and procedures in place to assure that the company and its employees maintain the highest standards of corporate conduct.

Principle V – Board Meetings
Principle V states that the board *"should meet sufficiently regularly to discharge its duties effectively"* and that *"ample opportunity must be given to all board members during meetings to convey their opinions and discuss issues set on the board agenda so that they honour their responsibilities at all times".* The supporting principles urge the board to set procedures to determine the frequency, purpose, conduct, and duration of meetings. The board should meet regularly, at least once every quarter, and notice of the dates of the forthcoming meetings together with the supporting material should be circulated well in advance to the directors so that they have ample opportunity to appropriately consider the information prior to the next scheduled board meeting. As a rule, the agenda should strike a balance between long-term strategic and shorter-term performance issues.

In the conduct of board meetings, the chairman should facilitate and encourage the presentation of views pertinent to the subject matter and should give all directors every opportunity to contribute to relevant issues on the agenda. After each board meeting, minutes faithfully recording attendance and decisions should be prepared and be made available to all directors as soon as practicable. Board meeting attendance should also be reported to shareholders at annual general meetings.

IV. The Duties of Directors

This is one of the most important areas of company law, and in the wider law practice for those who practice in corporate law. Indeed, if one practices particularly in corporate law one will require a deep understanding of the duties of directors as a lot that has to do with the decisions and conduct of companies is ultimately the responsibility of directors and one will be asked by both companies and directors what their duties are in given circumstances and one may not be asked specifically to give an opinion or advice on the duties of directors, but because of the nature of the advice being given to the company generally one will be advised to point out existing duties incumbent on directors that they must be aware of. In truth, the overwhelming majority of business transactions are conducted by companies which, in turn, are managed by a board of directors. The duties imposed upon them are wide ranging and can be very strict. Over the last ten-to-fifteen years, the issue surrounding the duties of the directors started to reach the courts, indicating the relevance of the director's duties in the way that the business is conducted. Issues to do with the duties of directors crop up regularly and in recent years not only have such duties come before our courts but especially because of the strict regulatory environment of the present, such issues appear regularly.

One will realise that the duties imposed on directors are serious in nature and numerous. The question we ask ourselves is why they have so many duties that are both serious and loaded with significant repercussions for those who do not follow them. In truth, directors have a lot of power and with power comes heavy responsibility. The law says that directors have a lot of powers because of, essentially, what the Companies Act says in article 137. This means that all the residual powers of the company vest in the directors such that directors have all the powers of the company save for a few that by law or by the M&A are put on the shareholders. Today, directors have very strict duties that even go beyond what the Companies Act lays down. This is due to the fact that, as we all know, there are many laws in Malta which generally apply to persons, which includes a company. By and large, the laws that impose obligations on persons impose them too on companies. Yes, these are often imposed on the company per se, but many of these laws, however, also contain provisions setting out criminal offences in the event of a breach of certain provisions of the said laws and, technically, the company could be in breach of a provision in the Act that leads to a criminal offence. One will also find, however, directly or indirectly through article 13 of the Interpretation Act find another provisions that says that where a criminal offence has been committed by a company then the directors themselves are personally liable for the offence unless they prove that they have knowledge of the commission of the offence or in any case took every step to avoid its commission, with the onus of proof being on the directors themselves. *Vide* the income tax, VAT, health and safety, planning, environmental, and data protection laws.

In a company there are two principal organs, the body of shareholders (whose wishes are conveyed in a general meeting) and the board of directors (whose wishes are conveyed in far more frequently held board meetings). The important point to note for the purposes of this unit is that most of the powers of the company are vested in the latter. Another point to note is that directors are, as a rule, appointed by the shareholders, and that the first directors are specified in the memorandum, but

following that changes to the board are affected by the shareholders either in a general meeting or in a class meeting for those with the right to appoint one or possibly more directors.

Is it a good time to be appointed a director?

It is often asked whether it is currently a good time to be a director. In truth, there have been better times to be a director. The first period, from the passing of the Commercial Partnerships Ordinance in 1962 up to the coming into force of the Companies Act of 1995, the second period being from that point till 2007/2008, and the third period being from that point to the present. In the first period, there was very little in the law that set out the duties and the obligations of directors. Indeed, if one had to review the CPO one will find practically no provision dealing with duties of directors, with the exception of a few which do so very indirectly. What is worse, during that period, people in business, directors in particular, and even their advisors, believed that it was virtually impossible for a director to become personally liable for breach of duties. If one had to return to that period to analyse the conduct of directors one will undoubtedly come across situations where they would have breached the duties of today with no repercussions to speak of.

In the second period, the Companies Act was a major piece of legislation that contained several provisions on the duties of directors, and, at that stage, there started to be a growing awareness of the important role, functions, and duties incumbent on directors as there were some educational initiatives and little by little the concept began to take hold. Still, many directors and advisors were not yet convinced that this had a real impact on the duties of directors in practice.

A big change came about with the Price Club cases in 2007/2008 as with them personal liability had been imposed on directors of the Price Club group stemming from provisions in the CA on fraudulent and wrongful trading and it was only at that time when those judgements were delivered that directors began to take notice, creating a shift in mentality. Recently, this idea that directors have quite a lot of duties has increased exponentially because of certain laws in place which affect many companies, a breach of which could lead to personal liability. In particular, AML regulations have strict rules and the company, and its directors can be held liable for breaches.

Why is it that this area of the law is so complex and wide-ranging?

First, the sources of law of the duties of directors are many. The first of which is the CA which applies to directors generally. There are also provisions in the Civil Code which have to do with the duties of directors. There are also listing rules, today known as capital market rules which impose many obligations on directors of publicly listed companies. There are rules in every M&A which impose duties of directors and there could even be duties imposed in the contract of engagement of the director concerned, and finally there are all those specific laws seen above which also contain provisions which directly or indirectly impose obligations on directors, some of which impose them directly (e.g., the social security legislation).

Even the nature of the obligations of directors is complex. There exist, for example, duties of a general nature which are of a civil law nature. There are also duties of a criminal law nature, of a contractual nature, of an almost sui generis nature (e.g., those emanated from the M&A). This becomes complicated further still as much depends on the business carried on by the company and whether it is solvent or insolvent. It is one thing if the company is solvent and another if it is not. If the company is either bankrupt or heading towards bankruptcy, then, additional duties are imposed on directors, a breach of which could lead to personal liability. In a sense, it depends on the type of company being considered. Directors of a public company have a few more duties than those of a private company, and we are mostly concerned with those of the latter. But also, it depends on what sector the company is operating in. It is one thing for a company to be involved in general trade, it is another if it is involved in one of the highly regulated sectors (e.g., banking, insurance, investment services, etc.) whose directors have more obligations imposed upon them, some of which may lead to the imposition of heavy fines on directors and even the possibility of a criminal sanction.

This leads to a question which is often asked: *Should I or should I not accept to be the director of a company given that there are these responsibilities?* One must be extra careful today, ensuring that one receives the correct advice, and that there are proper measures in place to ensure that laws are observed. So long as the director is in the company of other directors who are very serious, and they collectively put into place proper measures and arrangements that no area of the law is breached then one should be able to accept.

The Juridical Nature of Directors

It is important to discuss this briefly because depending on what the juridical nature of directors is, applicable duties will apply. We have often considered directors to be both mandatories and also agents of the company. A mandatory is one engaged by the mandator to perform a task, and the law of mandate therefore applies. Agents are similar in concept to a mandate and directors have been considered as such. Simply put, mandatories deal with the internal dealings of the company such that the director is the mandatory and the company is the mandator; whilst the director is also regarded as an agent of the company when he is dealing with third parties. Therefore, when the director acts on behalf of the company he is regarded as an agent of the company, the company being the principal.

More recently, directors have also been regarded as fiduciaries after the introduction of fiduciary obligations provisions in the CA pursuant to article 1124A et seq. Much as we consider directors as mandataries, agents, and fiduciaries, in reality they occupy a sui generis position as the role goes beyond and of these three, and as such their duties go beyond those imposed by the law regarding those three positions. The figure of the director is a unique one with many concomitant obligations surrounding it.

In the case of ***Dr. Ian Refalo v. David Boweck*** (1993) the Court stated:

> *"Id-diretturi ghandhom jitqiesu bhala agenti jew mandatarji tal-kumpanija li tgawdi personalita' guridika u indipendenti mill-membri li jikkomponuha".*

In the case of ***Video-on-Line Limited v. Ian Giles*** (Court of Appeal, 25/02/2004) the Court stated:

> *"Issa huwa ndiskuss illi direttur f'socjeta' huwa meqjus bhala mandatarju tas-socjeta' fir- relazzjonijiet nterni ma dik is-socjeta' filwaqt li huwa kkunsidrat bhala r-rapprezentant ta' dik is-socjeta 'firrelazzjonijiet taghha ma' terzi persuni".*

Prof. Cremona in his book 'The Law on Commercial Partnerships in Malta', stated:

> *"According to law, directors, in their internal dealings with the company are the mandataries of the company and in their dealings with third parties are the agents of the company: in the former case the general principles of the law of mandate and in the latter those of the law of agency would apply".*

More recently around 2004, directors have begun to be regarded as fiduciaries of the company, and, as such, are subject to the fiduciary obligations found in the Civil Code. In reality, directors have *sui generis* duties imposed on them primarily by the Companies Act. More importantly, a director is a creature of a statute, and his obligations are intrinsically *sui generis* and not mainstream.

To whom do directors owe their duties?

The general rule is that directors owe their duties to the company per se, as directors do not owe them to the individual shareholders, but to the body of shareholders as a whole and to the company as a separate legal person; directors are required to take into account the interests of members and employees, but their duty is to the company. This has been established in jurisprudence (***Percival v. Wright*** (UK), ***Michael J. Falla v. John H. Sorotos*** (1976)[1], and ***Sant Fournier v. Attard Montaldo*** (2001)[2] (Malta)).

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[1]In this case, there was a company, where Mr Sorotos was the director of such company and Mr Falla was a shareholder. Plaintiff alleged that Sorotos qua Director breached his duties as a director. As a consequence of the breach of duties, damages where suffered and Mr Falla as a shareholder made a claim for damages against Mr Sorotos. However, the court held that the duties that are owed by a director are owed not to the individual shareholder but to the company itself:

> *"a shareholder can sue in his own name only if an alleged infringed right is an individual membership right. Otherwise, only a representative action is possible".*

[2]This Maltese judgment follow English case-law of Percival v Wright, whereby it is held that the duties of the directors are primarily owed to the company itself:

> *" ... huwa kuncett stabbilit li l-obbligi tad-diretturi ghandhom ikunu rivolti lejn l-interess massimu tas-socjeta' innifisha u mhux lejn il-membri tal-istess socjeta' tant li hija l-kumpanija stess li ghandha d-dritt tinforza l-istess obbligi, b'dan li l-istess diretturi ghandhom dejjem jagixxu fl-*

This means that if a shareholder, or if a few of them, allege that a director has breached his duties, it cannot be that shareholder or those few shareholders who can take action against the director for breach of duties, but it must be the company as the proper plaintiff in such a case.

This, of course, creates a problem in the sense that the shareholders complaining may be in a minority with no representation on the board. There exists a remedy in such cases which shall allow the shareholder complaining to act through the company to take action against the directors, pursuant to article 402 of the Companies Act. Directors do not owe duties only to the company, however, as they owe them also to the regulatory agencies. If there is a breach of some of the laws seen above, these agencies, such as the PA, can take action against the director themselves. In a sense, directors also owe their duties in certain circumstances to the creditor of a company. As a rule, once the company is solvent and continues to be such, creditors have no involvement at all because, by definition, if a company is solvent creditors are being paid and continue to be paid. On the other hand, if a company is either insolvent or approaching insolvency, then, to begin with there are rules in the CA which impose additional duties on directors to protect creditors (*vide* the Price Club cases where the courts acknowledged expressly that in such situations directors have duties to creditors also).

Duties to Creditors

Directors may, in certain situations, also owe duties to the creditors of the company. As a rule, as long as a company is solvent, and able to pay its debts as they arise, then directors wouldn't really owe duties to the creditors of the company but if a company becomes insolvent or even if a company is heading in the direction of insolvency, then there are court judgments and also statutory provisions that impose liability on directors towards the creditors of the company. As far as statutory provisions are concerned, the main ones are Article 315 and Article 316 of the Companies Act which talks of wrongful trading. Article 316 holds, then when a director becomes aware of the possibility of insolvency, he needs to do everything within his power to protect the creditors. On the other hand, Article 315 condemns the fraudulent intent that a director has towards the creditors.

Thus, once the company is insolvent, a major change in interest takes place. The members' residual interest in the company's assets is replaced by the interest of the creditors, who will be repaid, if at all, from those assets.

Lord Templeman in the case of ***Winkworth v Edward Baron Development Co Ltd.*** stated:

> *"... a company owes a duty to its creditors, present and future ... to keep its property inviolate and available for repayment of its debts. The conscience of the company,*

> *interess tal-istess socjeta', in bona fede, u skond ir-regolamenti tal-istess socjeta".*

> *as well as its management, is confided to its directors. A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors".*

Duties to the State

There are certain statutory provisions that one could argue that the duty is owed to the state, in relation to VAT, Income Tax, Social Security etc. Even the interests of employees will lead one to the conclusion that directors also owe duties to employees as a general rule.

Categorisation of Duties

There are some very basic distinctions that need to be made. There are duties of a general nature that emanate principally from the CA and also from general principles of the Civil Law. Incidentally, we are here concerned with the former. There are duties then of a specific nature usually of an administrative nature, and these will primarily but not exclusively be found in the CA. Third, there are those duties, a breach of which can lead to criminal liability on the part of directors, imposed by special legislation, including: the Interpretation Act (if a criminal offence is committed then liability can be vicariously imposed on the directors); the Environmental Protection Act; the Income Tax Act; Health and Safety Legislation; Data Protection Legislation.

Duties of a General Nature

Duties of a general nature also has four sub-categories: first, duties of loyalty; second, duty to exercise due care, diligence, and skill; third, duties on the director as a mandatary; fourth, duties on the director as a fiduciary.

However, the general duties as outlined in Article 136A (2) are also worth noting:

> (2) *The directors of a company shall promote the well-being of the company and shall be responsible for:*
> (a) *the general governance of the company and its proper administration and management; and*
> (b) *the general supervision of its affairs.*

One of the clearest descriptions of a director's general functions was given by Sir Robert Crichton-Brown CBE, Federal President of the Institute of Directors, Australia, in an address given in February of 1972, in which he said the following:

> *"In practice, it can be said that the board is responsible for laying down matters of principle, and of accounting, statistical and management procedures. It is responsible for the decision of what manufacturing capacity is required, of how spare capacity should be utilised, of investment decisions, of the development of its property, the purchase*

> *of capital assets, the return of funds, as to where funds should be invested, cash flow and, of course liquidity. The director is concerned with performance, with the proposals and the budgets that are brought up by management. He is concerned with performance within those budgets, the funds required for those budgets; if the funds are not used, he will want to know why; if more funds are used, he will want to know why. He is concerned with the performance of the various divisions or units within a company and with turnover and the return on funds. He is concerned as to financial commitments, whether committed, possible or probable, whether immediate, short term or long term and should try to look five years or further ahead. He is concerned with the major contracts and obligations that the company may enter into. In brief, he is concerned to see that top management effectively does its job, that proper reports are made, and information given".*

It is also important to note that unless the M&A expressly provides for it, directors are not allowed to delegate their powers of management.

Duties of loyalty

"Since a company has no physical but only a legal existence, the management of its affairs is entrusted to the directors, through the medium of a company, by investors and shareholders. This is the main reason the duty to act honestly and in good faith in the best interests of the company is alleged to be the most fundamental duty owed by the director to the company. Good faith may be described as the basis of the duty of company directors as it must be present in every decision and action they take".[3]

The duties of loyalty that emanate almost entirely from the Companies Act can be divided into seven specific duties:

1. **The duty to act honestly and in good faith in the best interests of the company:** This is probably the core duty of directors. It is arguably the most important duty that directors have to act in the best interests of the company in whatever they do and to do so honestly and in good faith. A serious director would not be too troubled by this duty as such a director would typically act in this manner. This duty is judged on common sense principles and even if the decision taken by the directors turns out to have been a wrong one from the business point of view, as long as that director acted in good faith in the subjective belief that the decision which they were taking was the right one, then there will be no liability. Take, for example, directors which may decide to engage in a new project which did not turn out to be viable. Shareholders may claim they took the wrong decision and should therefore be held responsible, but in truth this would not be the case. With respect to the business judgement rule, *vide* the English case of ***CharterBridge Corporation v. Lloyd's Bank***

[3] Maria Sciberras, *Duties and Responsibilities of Company Directors*, 2007

(1970).[4] When we say that directors have to act as such, we mean that the directors must act in the best interests of the company itself, not of the individual shareholders. However, one may argue that the duty to act in the best interest of the company also takes into account the interests of the shareholders. This was outlined in the case of ***Caroline Zammit Testaferrata Moroni Viani et v. Testaferrata Moroni Viani (Holdings) Ltd. et.*** (FHCC, 30th August 1999).[5]

2. **The duty to remain within their powers:** The relevant provision is contained in article 136A (3)(e) of the Companies Act which states that directors are obliged to exercise their powers for the purposes for which those powers were conferred and not to misuse them. A director must ensure that any decision he takes will be for the purpose for which the powers conferred upon him. He has got to ensure that the powers are exercised for the purpose for which they were granted and as a corollary of this, to ensure that a director does not misuse those powers. These principles here remind us of the doctrine of *ultra vires* considered previously. A company has an objects clause in its memorandum, and it cannot act beyond what is stipulated within it. Considering the fact that it is directors who act on behalf of the company, they would be breaching this particular paragraph in article 136A should they contravene the company's objects clause. *Ultra vires* also has another significance, such that it is where the directors act within the objects of the company but outside of their own powers as directors. The notion of good faith does not come into it. Even if directors act in good faith, if they overreach their powers and act outside of their powers, they would still be liable, notwithstanding that they would have acted in good faith and in what they believed was in the best interests of the company.

   Take, for example, a company whose articles state that any decision that the company wishes to take that exceeds an expenditure of €100,000 cannot be taken by the directors alone but must be given shareholder approval. The company incidentally would be bound vis-à-vis third parties, but they would have acted beyond their powers. In this case, there is no question of good faith, such that even if the directors state that they acted in good faith, it would not save them from liability.

   This can be read in conjunction with Article 137(3)[6] which holds that the directors are only to perform those duties conferred to them by the Companies

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[4] *"The proper test ... must be whether an intelligent and honest man in the position of a director of the company concerned, could in the whole of the existing circumstances have reasonably believed that the transactions were for the benefit of the company".*

[5] *"Id-diretturi ghandhom jirrappresentaw direttament l-interessi tal-azzjonisti ... Huwa ovvju li l-bord ghandu jopera ghall-ahjar interess tas-socjeta' in kwestjoni u tas-socjetajiet sussidjarji. In partikolari, pero', c-chairman ghandu jhares l-interessi tal-azzjonisti kollha inkluzi dawk it-terzi li ghandhom ishma minoritarji fis-socjetajiet sussidjarji ".*

[6](3) *The business of a company shall be managed by the directors who may exercise all such powers of the company, including those specified in article 136, as are not by this Act or by the memorandum or articles of the company, required to be exercised by the company in general meeting.*

Act and by the M&A except for those powers which are reserved for the shareholders. There are certain powers that the company is bound by, being its object clause. Directors cannot exceed the powers granted to them by the company. Sometimes a decision may be taken, which is intra vires the company but ultra vires the powers of the directors themselves. In such case they may exonerate themselves from liability by obtaining the approval of the shareholders, and thus not breaching Art 136A.

Farrar: *"The powers given by the articles to the directors are held in trust for the company and must not be exercised for any purpose other than that for which the power was given. If they are so exercised, the transaction may be set aside despite the directors' assertions that they honestly believed it to be in the best interests of the company".*

3. **The no-conflict rule:** The first scenario of self-dealing. If there is a breach of the no conflict rule or the no profit rule the director has somehow derived a benefit for himself by dealing with himself. The general principle is that a director must not allow himself to get into a position where his personal interest conflict with those of the company. This means that a director must not put himself in a position where he is in a conflict with a company or where his personal interest conflicts with those of the company. In the case of ***Camilleri et v. Ragonesi noe*** (Court of Appeal, 13th May 1991) the Court held that:

> *"Hu principju assolut li direttur qatt ma ghandu jpoggi lilu nnifsu f'posizzjoni li jkun hemm konflitt bejn id-doveri tieghu lejn ilkumpanija tieghu u bejn l-interess personali tieghu ".*

In the case of ***Mary Grech v. Joseph Chetcuti*** (2004), the Court went as far as holding that a resolution taken by a board of directors where the directors had a personal interest in the resolution taken is null and void.

Take, for example, a company X Ltd. in the business of hotel development where one of its directors, Mr. Y, owns a construction company. Mr. Y therefore has a conflict of interest. It does not mean that the director cannot be a director with regards to another company. However, the no-conflict rules persist *"where a director has a pre-existing and continuing duty to the company which he then jeopardises by secret discussions with the outsider which will benefit him in a personal capacity"*.[7]

Is there a prohibition against a company entering into a transaction where one of its directors has a conflict of interest? The simple answer is no. As a rule, if a company, despite knowing that one of its directors has a conflict of interest, wishes to enter into a transaction with that director then it is up to the company to do so. When one is advising a company in such situations must not advise based on the general rule but must consider the M&A of the company because

[7]Maria Sciberras, Duties and Responsibilities of Company Directors, 2007

it may be that the company has a particular provision in either that state that it cannot enter into a contract where a director has a conflict of interest. Regardless, a fundamental and overriding rule is that a director who knows that a transaction is being proposed in which he has an interest is obliged to bring that matter to the attention of the board of directors during the meeting in which the proposal was made, or, if he was not present, at the very first available opportunity (this does not mean at the next meeting, but upon realising that such a transaction is to be made), pursuant to Article 145.[8] Once the conflict has been brought to the attention of the board the company can still chose to enter into the company nonetheless so long as it is not prohibited by the M&A.

This raises multiple questions. For example, *when a director is obliged to bring to the attention of the board the fact that he has a personal interest in the transaction, will he be able to vote as a member of the vote on that transaction?* This depends on what the articles of association state. Some allow for a vote, but the majority prohibit the director from voting on the matter, especially from the corporate governance point of view. In recent years, the articles of association tend to be drafted in such a manner to prohibit voting on matters for conflicted board members. With respect to discussions on the proposed transactions and whether the conflicted director can be present, articles of association usually do not regulate this matter. To adhere to the high standards of corporate governance, it is advisable for the director to not participate in the discussion at all, neither in nor outside of board meetings. This would avoid the possibility of shareholders raising corporate governance and probity concerns.

Another issue which has arisen in the case of conflicts of interest is *what if one has a situation where one has a holding-subsidiary relationship, and the holding company appoints Mr X on the board of the subsidiary and then a transaction is proposed to be entered into between the subsidiary and the holding company. can the director appointed by the holding company on the board of the subsidiary qua director participate in and vote on discussions for such matters?* The general view is that no such conflicts exists as when the law speaks of a personal interest it is speaking of an interest in the transaction in which the director has some direct or indirect personal interest. Him having been appointed by the holding company does not mean that the approval of the transaction will benefit him. What will be important for the subsidiary in a situation like this, especially if it has shareholders other than the holding company, is to ensure that the transaction is entered into at arm's length, i.e., that it is done on terms which are fair and commercially the norm, and that the holding company does not receive an unwarranted and discriminatory benefit.

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[8]**145.** (1) *It shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest to the other directors either at the meeting of the directors at which the question of entering into the contract is first taken into consideration, or, if the director was not at the date of that meeting interested in the contract or proposed contract, at the next meeting of the directors held after he became so interested.*

(2) *Any director who fails to comply with the provisions of this article shall be liable to a penalty.*

What if a director is in a litigation with a company on whose board he sits? There is clearly a conflict here. Given that a director is as a rule entitled to all information within the company, can he insist that he is present for a discussion of the board on this litigation that concerns this particular director. Although there is nothing in the law that regulates this, the board of directors would be entitled to inform the director to not be present for such discussions and to prevent access relating to documentation.

4. **The no profit rule:** The second scenario of self-dealing, pursuant to articles 136A (3)(b) and (3)(d). This is a fundamental rule that needs to be taken into account by directors. It is one of those obvious rules which any director who has common sense and a high sense of integrity will take for granted. The rule is such that a director cannot make any personal profit from his position in the company, from confidential information, and cannot use property from the company or take any corporate opportunities of the company unless he is so authorised by the company. With respect to corporate opportunities, take, for example, a company in the business of software development whose director himself is an expert on the matter. One day, the director is approached by another company to do software development for them. The director cannot, at risk of breaching his duty of loyalty, do the software development in his own name and personal capacity. Instead, he must bring the proposed assignment to the board. If the company rejects it, then and only then, he may seek permission to perform the task himself. Profit-making by directors include: (i) the misuse of information; (ii) the use of corporate opportunities belonging to the company; and (iii) insider dealing.

   In the case of ***Industrial Development Consultants Ltd. v. Cooley*** (Canada) The Canadian court emphasised that the director had breached his obligation even though at the time that he was approached about his work, he was not acting as a director. The court made it clear that a director is bound by this obligation even if he is on vacation and in a scenario where he does not have to do with the company. The managing director who had resigned that position to take the benefit of a contract he had secured for himself when negotiating for the company, was made accountable to the company for the profits or 'unjust enrichment' he would derive from that contract. The judge held that as a managing director it was his duty to promote the interests of the company, whereas, in the last few months of his directorship, Cooley had spent his time mainly promoting his personal interests. On this basis he was accountable for the profit made, even though he had signed the contract only after resigning his directorship. The duty to put the company's interest first had attached to a course of conduct which he had put in train while a director and his resignation did not relieve him of that duty.

   In the case of ***Canadian Air Services Ltd vs O'Malley*** (Canada) the plaintiff company's job was to take on contracts for aerial manning of large areas. The Canadian govt had funded the aerial mapping of the state of Indiana and the company was approached – the company had two directors. During the course

of negotiations these two individuals resigned from Canadian Air Services Ltd and set up their own company and took on that contract themselves. They poached the contract; the plaintiff company sued such company, and the Court came to the conclusion that doing what they did was a clear breach of their duties as fiduciaries of the company.

With respect to confidential information and the use thereof by a director for personal gain, the insider dealing rules of listed companies apply (should the company be publicly listed). There is there a rule that a director cannot disclose or make use of any price-sensitive information about the company. Take, for example, a company whose director knows that the company on whose board he sits will imminently enter a lucrative contract for itself, a transaction that has not been made public yet but will likely mean that the price of the shares will increase. If this director armed with this knowledge goes out in the market and buys shares in the company at the average price at which they are being sold, then he would have breached the insider dealing regulations which is both a civil misdemeanour and a criminal offence.

With regards to the 'use of property' as part of the no-profit rule, Prof. Cremona holds that where a director acts in violation of this prohibition, the company may, at its option, either take action for damages and interest against him or demand payment of any profits made by him in contravention thereof. This sub-article is to be interpreted widely to also include any corporate opportunities that the business may encounter and instead, the director stands in the way of such business opportunity from yielding the company profit.

5. **The duty not to take benefits from third parties unless they are entitled to do so:** With respect to the type of benefits being discussed, the typical cases involve bribes or unlawful commissions on a transaction that the director may have well negotiated on behalf of the company. A point that needs to be made is that the benefit need not be necessarily payable in cash but may be also payable in kind. Also, even if the company on which he sits happens to gain and profit from the transaction, the director will still have breached this particular obligation. In other words, the director would still not be able to justify his actions in this respect.

6. **The duty not to compete with the company:** A director is bound not to compete with the company on whose board he sits. The rule, as contained in article 143 of the Companies Act, states that *“a director of a company may not, in competition with the company and without the approval of the same company given at a general meeting, carry on business on his own account or on account of others, nor may he be a partner with unlimited liability in another partnership or a director of a company which is in competition with that company*”. It is possible for him to be on the boards of both companies only if there is general meeting approval by both companies. In reality this approval is almost never given in the few cases where it has been sought. Similarly, a director cannot be in competition with the company in his own name. Take, for example, the

aforementioned example of the software development company, Mr X should not consult for other competing companies in his own name.

7. **The duty to exercise an unfettered discretion:** Unfettered discretion means discretion not bound in any way. The principle is such that a director cannot agree to have his discretion to decide on a board of directors restricted by some agreement with anybody else. Usually, that somebody else would be the shareholder who is appointing that director. Take, for example, a director appointed by a particular class of shareholders which offers appointment to Messrs X, Y, and Z on the condition that whenever they are about to discuss or decide on any matter at the board, they are told in which way to vote by that particular class of shareholders. X, Y, and Z cannot agree to enter into such a commitment. This is because this would conflict with the fundamental rule of loyalty that directors have an obligation to act honest, in good faith, and in the best interests of the company, not individual shareholders. With respect to the notion of nominee directors, at least in common parlance, a nominee director would act according to the interests of the shareholder appointing them. This would naturally be wrong.

   Take, for example, a company X Ltd. with three classes of shareholders, each being entitled to appoint one director to the board. One would not be able to enter lawfully into an arrangement with the shareholders that appointed him, that would bind one to vote in a particular way when it comes to decisions on the board. A shareholder who has appointed an individual to the board, may feel that because he has appointed him, then he can determine how that director is to vote and he feels that the director should be bound to vote as the shareholder tells him to vote. That is wrong and any such commitment on the part of the director to be bound by what directives his shareholder tells him would be unlawful. Directors are bound to act within the interests of the company.

The Duty of a Director to Exercise Due Care, Diligence, and Skill

The fundamental rule pursuant to article 136A (3)(a) is that the director of a company must exercise due care, diligence, and skill in the exercise of his functions:

> (3) *In particular, but without prejudice to any other duty assigned to the directors of a company, or to any one of them, by the memorandum or articles of association or by this Act or any other law, the directors of a company shall:*
>
> (a) *be obliged to exercise the degree of care, diligence and skill which would be exercised by a reasonably diligent person having both -*
>
> (i) *the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and*

> (ii) *the knowledge, skill, and experience that the director has.*

The law goes beyond this by setting out two standards that a director needs to abide by, one of which is subjective, the other objective. Both must be satisfied. The objective standard is set out in article 136A by stating that a director be obliged to *"exercise the degree of care, diligence and skill which would be exercised by a reasonably diligent person having the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company"*. In assessing the behaviour of a director as a defendant the court would compare what the director has done with what a reasonable director would have done in a similar company. The director is also judged based on the *"knowledge, skill and experience that the director has"*, i.e., a subjective standard.

If the subjective standard is below the objective one, or vice versa, the law does not offer a preference, but a court would most likely consider all the evidence and come to a conclusion on the merits of the case holding the director to the higher standard as the case may be. However, it must be noted that in order to succeed in an action for negligence, the plaintiff must prove: (1) that the director owed the plaintiff a duty to carry out his duties with skill and care; (2) that the duty was not exercised; and (3) that the plaintiff suffered loss.

Gower argues that the proposition *"prescribes a test which is partly objective (the standard of the reasonable man), and partly subjective (the reasonable man is deemed to have the knowledge and experience of the particular individual)".*

Therefore, by way of example, in the case of ***Norman v. Theodore Goddard***, Judge Hoffinann observed that *"a director who undertakes the management of the company's properties is expected to have reasonable skill in property, but not in offshore tax avoidance".*

In the case of ***Sant Fournier v. L-Avukat Dottor Philip Montalto*** (FHCC) the Court held that:

> *"Ghalkemm kull direttur ghandu duty of care and skill u li jagixxi fl-interess tas-socjeta' innifisa, xorta jibqa' l-fatt li huwa aspett importanti li il-grad ta' kapacita' ta' l-istess diretturi fl-istess kumpanija ivarja, ghaliex mhux kull direttur ghandu jew huwa mehtieg li jkollu specjalizzazjoni fit-tmexxija tal-istess negozju adoperat mill-istess kumpannija".*

The Duties of a Director *qua* Mandatory

Simply put, the duties imposed by the Civil Code on mandatories are, *inter alia*, as follows:

1. To carry out the mandate.

2. To render to his mandator an account of his management.
3. To give everything that he has received by virtue of the mandate, even if what he has.
4. received was not due to the mandator; and
5. To not delegate his authority by substituting another person for himself unless he has been empowered to do so by his mandator [*delegatus non potest delegare*].

Under the law, directors have always been considered mandataries and, more recently, they have been considered as fiduciaries because of a set of sections that were introduced in the law in 2004 in the Civil Code relating to fiduciaries. There is no doubt that a director is a mandatory of a company with the company being the mandator. Remember that a mandate is a contract where somebody engages someone to do something on their behalf. there is no doubt that a director is engaged to do something for the company and traditionally they have been regarded as mandataries. Therefore, incumbent on them are the duties of mandataries under articles 1873 *et seq.* of the Civil Code.

One duty of a mandatary is to carry out his mandate. This may sound obvious and in the context of directors an important, perhaps practical corollary of this, is, for example, to attend and prepare for board meetings. Another duty is to render an account for one's mandate, i.e., to give appropriate explanations of what one is doing. Another duty of mandataries is to pass on to the mandator anything that the mandatary exercised in the exercise of his functions even if the mandator was not entitled to receive whatever it was that the director received. Therefore, if a director receives some kind of payment, he must pass it on to the company. another duty of a mandatary that is relevant in this context is a duty not to delegate his or her powers as a mandatary to somebody else unless he is specifically authorised to do so. This means that a person who has been engaged as a mandatary must carry out the task himself, i.e., *delegatus non potest delegare.* This is relevant in the context of the discussion of alternate directors, i.e., a person who is appointed by a director to attend board meetings in one's place. This is, at law, a delegation of authority, so the principle shall apply. Therefore, for a director to be able to appoint somebody else as an alternate director that director will need to have already been authorised to delegate his powers and that is generally done in the articles of association by a provision or a set thereof that regulate the appoint of alternate directors. This is important in practice when one is acting as a company secretary or the legal advisor to a company. Whilst some articles of association that have a provision entitle a director to appoint any person as an alternate director, one will also find provisions that entitle a director to appoint as an alternate director only, for example, another director or a person who has the approval of the majority of the board.

The Duties of a Director *qua* Fiduciary

There is little doubt that a director qualifies as a fiduciary. The provisions on fiduciaries were introduced in the Civil Code in 2004 and there is a definition of sorts of when fiduciary duties arise and one of the scenarios is where we have a person in a position of trust and no doubt a director is in one. A particular case appears to find difficulty with applying the provisions relating to the duties of a fiduciary to directors and appears

to say that once there are duties of directors already set out in the Companies Act then those are the duties that apply to directors and the duties of fiduciaries do not apply.

There are two broad duties of fiduciaries:

1. **To act honestly and with utmost good faith:** This duty cannot be subject to a contrary agreement, i.e., it is an overriding fundamental duty on fiduciaries and the fiduciary and the person engaging him cannot agree that the former is not liable for breaches of this. Another point to be made is that if one were to compare this with the duty imposed on directors the duties on directors, state that a director is obliged to act honestly and in good faith whereas a fiduciary is obliged to act honestly and with utmost good faith, which would appear to suggest that fiduciaries are held to a higher standard. In practice, however, directors are already held to a higher standard by the courts.

2. **To act with loyalty, with a duty of care, and with a number of administrative duties applying also:** These duties, unlike the first general duty, can be subject to contrary agreement such that they can be excluded by agreement.
    a. **Duties of loyalty:**[9]
        i. The duty of loyalty, in the case of a fiduciary, means that a fiduciary must avoid conflicts of interest, similar to the duties of the director.
        ii. A fiduciary cannot make any undisclosed personal gain out of his functions, also similar to the duties of the director.
        iii. There is a duty imposed on fiduciaries, when they act for several people, to act impartially in the exercise of their functions. In the case of the CA there is no such duty perhaps because the director acts exclusively for the company.
        iv. If for whatever reason the fiduciary receives instructions to return any property which he holds as a fiduciary or if the agreement is terminated, such property must be returned forthwith. This duty, again, is not specifically mentioned in the Companies Act.

    b. **Duties of Care:** Directors must exercise due care, diligence, and skill in the exercise of his functions and the Companies Act sets out two standards. In the case of fiduciaries, the law states that one is bound to act as a bonus paterfamilias. Theoretically, there is a difference between the two as in the CA the director is also judged by his own subjective standard so if one is a particularly high one, he will likely be held to a duty higher than that of the *bonus paterfamilias*, which is objective.

    c. **Administrative duties:** An important one is to keep the property which one holds as a fiduciary segregated from his other property. If a fiduciary

[9]In the case of ***Vascas Enterprises v. Adrian Ellul*** (FHCC, 2014) the court drew from English case-law which held that a fiduciary relationship exists between a director and the company. The director, under a fiduciary duty requires him to owe a single-minded duty of loyalty to the company and act in the company's best interest. The court held this principle applies in Malta.

has received funds to do with the exercise of his duties, he must co-mingle those funds with his own, but must create a separate account. There is no similar express provision in the case of directors and the Companies Act but it is an applied duty in any case. Administrative duties are the following: a) to keep any property as may be acquired or held as a fiduciary segregated from his personal property and that of other persons towards whom he may have similar obligations; (b) to maintain suitable records in writing of the interest of the person to whom such fiduciary obligations are owed; and (c) to render account in relation to the property subject to such fiduciary obligations.

d. **The duty to keep adequate records:** There is a specific provision obliging fiduciaries to keep records of whatever they are doing in the exercise of their functions and a complementing duty to render an account of what he is doing. Again, there is no such express provision when it comes to the duties of directors under the CA.

In the case of ***Amadeo Balzan v. Balzan Ruggier, Ruggier & Central Holidays*** plaintiff was a shareholder who held almost 49% of the shares in the company and was also a director. Balzan Ruggier, and Ruggier, where also shareholders in the company and two of the three directors. What the plaintiff claimed in this case was that the defendants had acted as directors to the prejudice of the company and to his own personal prejudice, also alleging that the directors had breached their duties as directors under the Companies Act and also their duties as fiduciaries under the Civil Code. In the judgement the court made reference to the fact that what the plaintiff was alleging was a breach of the duties of the persons who were acting as directors but also claimed a personal loss to himself. The court made an important point that duties of directors are owed to the company per se such that any claim which is to be made against the directors needs to be made by the company rather than by the individual shareholders. The court also referred to the situation where an individual shareholder might not be able to in practice get the company to sue the directors for a breach of their duties as that shareholder may not be in control of the board of directors. There is therefore a remedy called the derivative action pursuant to article 402 of the Companies Act. What the judge said was that the plaintiff did not have the right to institute an action in the company's name.

The judge entered into the interplay of the duties of the director under the CA and the duties of the fiduciary under the Civil Code. The court made the following observation: it said that there was no doubt that the plaintiff was invoking rights as a shareholder and of the company against the directors, such that the court therefore said that the context was the duties of directors under the CA. The court said that these duties are contained in a specific set of provisions. The court appeared to say that one has to apply the principle of the Latin maxim *lex specialis derogat generalis*, implying that the duties of fiduciaries have no role to play when it comes to the duties of directors as they are of a more general nature. If this was the approach that was taken it may be disagreed with. It is true that this maxim is a principle of Maltese law and of the Maltese interpretation of legislation. However, it only applies if there is a conflict between the *lex generalis* and the *lex specialis.* The rules contained in the Civil Code on fiduciaries

and fiduciary obligations are not necessarily in conflict with those of the duties of directors in the Companies Act. There are a few provisions that may be considered in conflict where this principle may be applied (e.g., the duty to exercise care, diligence, and skill according to the subjective skill under the Companies Act, and the duty to act as a bonus paterfamilias under the Civil Code), but there remain some provisions in the Civil Code that are of a more general application that have no counterpart in the Companies Act and therefore should apply, such as the duty to keep records, to segregate one's property from that of whoever is giving examples, or the duty to return property as soon as the fiduciary relationship is terminated.

In the case of ***Anthony Caruana & Sons Ltd v. Christopher Caruana*** (2014) the facts concerned the acquisition of the plaintiff company by a third company in 2001. At the time, the defendant was involved in the management of the plaintiff company, and he continued to be so involved. In 2003 a definite contract was entered into between the plaintiff and the defendant whereby the latter was engaged as a general manager of the company for the period of three years, i.e., between 2003 and 2006. Roughly midway through this period, the defendant general manager wished to leave and a contract of termination of employment was entered into where he was paid an amount by way of a terminal benefit, but he also gave a contractual commitment to act with continuing goodwill towards the company even after the termination of his employment. The plaintiff company, after the general manager left, discovered that he was up to some mischief in the sense that he began using confidential information that belonged to the company for his own personal business, approached customers of the plaintiff company, began operating in the same line of business, approached the suppliers of the plaintiff company, and managed to take over some brands before setting up a separate company owned by him to operate these new brands.

The plaintiff company alleged that Caruana:

1. Disclosed certain confidential information made available to him as a result of his employment as the company's general manager; and
2. Caused damages by trying to take certain products, poaching its employees, and approaching suppliers and customers to request them to deal with him and not with the plaintiff company. Through another company belonging to himself, he became the agent for product brands formerly represented by the plaintiff company; and
3. Occupied a position of trust and loyalty and should ultimately be deemed to be a fiduciary in terms of article 1124A of the Civil Code.

The plaintiff company alleged that by doing so he had breached his duties as a fiduciary as well as his contractual obligations.

The defendant said in his defence that he did not breach anything, that he was not a fiduciary in his capacity as general manager, and that, in any case, the provisions setting out the duties of the fiduciary under the Civil Code came into force after he had done the alleged wrongdoing.

In the first court it was said that the defendant was an employee of the company, a general manager at that, but even as such he did not qualify as a fiduciary because according to the court only directors or persons responsible for policymaking could be regarded as fiduciaries. The first court said, however, he still breached the provisions *ex contractu*, finding him liable for the payment of damages.

An appeal was filed, and the Court of Appeal significantly found that a general manager is indeed to be regarded as a fiduciary because he was indeed in a position of trust and was therefore subject to fiduciary obligations. The Court also considered the defence raised that the provisions were not applicable in any event as they came into forced after the alleged wrongdoing. The Court stated that indeed they had come into force after, but these obligations of a fiduciary have always existed and it referred to even Roman Law and that they had formed part of Malta's *jus commune* as a result, coming to the conclusion that the defendant had breached his obligations as a fiduciary and those emanating from the contract. What is relevant for our purposes is that the factual scenario could apply with equal force where a director leaves a company. The court also stated that in this case, the defendant also bound himself contractually to continue to act "with continued goodwill" to the plaintiff company which indicated a high level of loyalty. This entailed that Caruana had to act loyally vis-à-vis his former employer and not disclose sensitive information nor use such information for his own personal benefit to the detriment of the employer.

The court found that this abuse was in violation of the fiduciary obligations of the defendant which are now reflected in Art 1124A of the Civil Code and consequently, he was bound to pay compensation for the damage he has caused (circa €25,000).

Fiduciary obligations impose additional obligations besides the contractual obligations (in certain contracts). Moreover, the concept of fiduciary obligations is also not necessarily tied to the concept of trusts. It rather operates and has a general application in every case wherein a person acts in the interest of another person, in which case he is expected to act with due attention and care.

Duties of a Specific Nature

Administrative Duties Under the Companies Act

The specific duties arising out of the Companies Act can be broadly categorised under five headings:

1. Duties relating to the keeping of statutory registers and minute books.
2. Duties relating to the filing of returns and documents.
3. Duties relating to record-keeping and financial statements.
4. Duties relating to the liquidation of the company.
5. Miscellaneous duties.

The Companies Act mostly provides duties that are imposed on companies and/or duties imposed on the officers of the companies themselves. Some of these are duties of a general nature such as those that have been considered thus far, but there are many others of an administrative nature. Take, for example, the obligation to keep

registers of members, obligations to do with minutes, obligations to do with the filing of certain documents (e.g., resolutions, transfers of shares, changes of company secretary or directors, change of registered office), obligations to do with the keeping of accounts and with the financial statements of the company, obligations to do with the filing of the said audited financial statements, duties to do with scenarios of liquidation, etc.

These duties are imposed on the company and/or on the officers thereof. The latter are essentially the directors of a company and the company secretary. An auditor, incidentally, is not considered to be one. Practically all of these duties, if not all of them, carry a sanction with them if the duties are not observed, generally involving a penalty which can be at times a one-off or a one-off combined with a daily fine until the matter is rectified. These obligations are in practice imposed on the directors and often on the company secretary. Article 150 of the CA says that *"anything required to be done by a company under any provision of this Act shall be deemed also to be required to be done by the officers of the company".* It may well be that in the internal relationship between the directors and the CS these obligations are delegated to the latter or possibly to one or two of the directors. Even if that is done, and it often is, at law it is all the directors that are liable for any sanctions that have been imposed, in particular with respect to administrative fines. In other words, a director who is sued by the MBR to pay a fine for the failure to file a particular form cannot plead that he had delegated this duty to the CS.

Most of the above duties are backed by sanctions in the form of penalties enforceable by the Registrar (against the directors personally). It should also be observed that where the Act imposes obligations on all the officers of a company, the precise allocation of functions and responsibilities as an internal matter between the officers (say, between the directors and the company secretary) is something for the articles and, in the absence of any specific rules therein to the contrary, for the directors to determine. When the duties are not adhered to, the penalties by the Registrar can be imposed on the directors personally.

In the case of ***Architect Manjello Spiteri v. The Registrar of Companies*** (FH CC, 2015) there was a company in which there were three directors, one of which being the plaintiff. In June of 2008 both other directors resigned and in the following month plaintiff also resigned. Spiteri had in the month prior to his resignation received a claim by the Registrar of Companies for the payment of a fine imposed for failure to file the annual financial statements. In Court, the plaintiff argued that he ought not to have been saddled with this fine because he said the division of duties in the company amongst directors was as follows: he was responsible for technical matters, in particular the drawing up and submission of tenders; X was responsible for general administration; and Y was responsible for financial matters. Plaintiff stated that he was not responsible for dealing with such matters and that they should have been the responsibility of X and Y instead.

In truth, the court dismissed this out of hand, stating that when administrative fines are contemplated in the Companies Act, they are imposed on all of the officers of the company and that an officer cannot point in his defence that that particular function

was delegated internally. The court made reference also to articles 150 and 427(4) stating that *"a company shall be jointly and severally liable with its officers for the payment of any administrative penalties imposed under this Act".* The Court imposed payment and pointed out that plaintiff, pursuant to articles 427(4) could make a claim to the company to be compensated by it for the amount that he must pay based on the joint and several liability between them. The judge also pointed out that he could claim a proportionate share from the fine from the other two directors such that the payment is the responsibility internally of the company which was probably bankrupt making liability incumbent on the directors who are jointly and severally liable between themselves.

Specific Duties

1. Directors' duties in the group context

A director owes a duty to act in the best interests of the company he serves. Given that each company within a group is at law a separate entity, it follows that the directors of a subsidiary are not entitled to sacrifice the interests of that subsidiary in the interests of any other component within the group. Generally, therefore, the directors of a subsidiary owe no duties to the holding company, even though they are appointed by the holding company or are directors also of the holding company.

2. Duty to act as a board and no individually

In the case of ***Alexandra Balzan Ruggier v. Amadeo Balzan*** (First Hall Civil Court, 2015) the plaintiff was both a director and one of three shareholders in Central Holidays (Travel & Tourism) Limited. The defendant was the only other director and a minority shareholder. The plaintiff alleged that the Company was not being managed in accordance with its M&A because the defendant was continuously abusing his position by acting unilaterally in taking decisions relating to the operations of the Company without obtaining the prior approval of the Board of Directors. Accordingly, the plaintiff argued that she was effectively being prevented from exercising the rights conferred on her by the shareholders of the Company to administer the latter jointly with the defendant.

The defendant opposed the plaintiff's claims by asserting inter alia that:

(i) *Direttur m'ghandux bzonn jikkonsulta ruhu ma' hadd ghall-operat tal-kumpannija u dan johrog kemm mill-Companies Act kif ukoll mill-Artikolu 9 tal-Memorandum.*

(ii) *Di piu', l-intimat huwa l-managing director tal-kumpannija u allura aktar m'ghandux bzonn jikkonsulta ruhu mal-attrici ghall-operat tal-kumpannija.*

The Court was convinced that the defendant's actions were carried out in the best interest of the Company and that therefore he had complied with his duties at law. This was further evidenced by the fact that the auditor of the company had found no irregularities with respect to the management of its affairs by the defendant. On the basis of the foregoing, the Court found in favour of the defendant.

Joint and Several Liability

Article 147 states as follows:

> **147.** (1) *The personal liability of the directors in damages for any breach of duty shall be joint and several:*
>
> *Provided that where a particular duty has been entrusted to one or more of the directors, only such director or directors shall be liable in damages.*
>
> (2) *A director shall not be liable for the acts of his co-directors if he proves either –*
> (a) *that he did not know of the breach of duty before or at the time of its occurrence and that on becoming aware of it after its occurrence he signified forthwith to the co-directors his dissent in writing; or*
> (b) *that, knowing that the co-directors intended to commit a breach of duty, he took all reasonable steps to prevent it.*

In such cases of a breach of duty, directors are jointly and severally liability. If there is a board of directors and one member of the board breaches his duty, there is a presumption that the other directors sitting on the board are severally jointly and severally liable with that director. The exceptions to this are that if a particular task/function has been entrusted to one particular director, it is only that director that will be liable if there is a breach in that particular. In the context of executive vs non-executive directors, this exception may play an important role. This is because in a BOD composed of both forms of directors if for example an executive director is entrusted with keeping records of the company in such cases, the other directors, particularly, non-executive directors will not be liable. Given that it would be executive directors who would be delegated with such administrative tasks, executive directors would have more responsibilities.

Risk Mitigation

Note that directors, particularly of certain companies, have very stringent duties which, if breached, could lead to significant sanctions. There exist many other laws which pose duties on companies and directors, the breach of which could either lead to the imposition of significant fines on the directors personally or even to criminal penalties.

In order to lessen the risk of liability, one must first attempt two things: first, determine what type of company the director is a director of (it is one thing if the company is a single-member or private company holding a single property, it is another if it is a fully-fledged company having hundreds of employees, thousands of customers, in the banking or insurance sector where many laws apply); second, determine what set of obligations one is truly considering (mitigating risks depends on the set of risk being considered, e.g., the sets of duties in the Companies Act and Civil Code, the risk of penalties for the breach of administrative duties under the CA, breaches under the Health and Safety Act, etc.).

Generally speaking, what needs to be done by every director in whatever type of company he operates in:

1. **Are you sure you are ready to be a director?** If one is so risk averse or simply does not have time, they should not take on the task of being a director.

2. **Have you looked into what company you are being asked to join and who your fellow directors will be?** It is one thing being a director of a simple company and another being one of a highly regulated company. It is one thing being the director of a company with a good reputation and another being the director of a company in trouble. It is one thing to have fellow directors who exercise high levels of competence and integrity and are experienced, and another joining a board of those who only put their interests first. This is an exercise which really should be done.

3. **Will you always attend board meetings and be prepared and available to do so?** There are many boards composed of some directors who go to a meeting simply have been present and participate there and then, without having done enough reading and preparation. A serious company should through its CS and Chairman prepare a board pack with proposals to be discussed, etc. In a board one might find a dominating CEO or Chairman who might not allow either much time for discussion or might not provide all appropriate documentation, and who does not easily take any challenge. If one is in that situation as a director, one will have two options: either to challenge them, or to leave the company altogether. Generally, the board, especially today, given that laws have indeed become more complicated, and duties are stricter, should seek advice when something is not entirely clear. Boards, admittedly, are not always keen on doing so to pass decisions quickly and to avoid costs.

4. **Have you delegated some of your responsibility?** Other general points to keep in mind is that article 147 states that directors are jointly and severally bound amongst themselves vis-à-vis their duties in the Act. That section, however, also says that if a particular duty has been delegated to a particular director, then the others should be able to decline liability (N.B., this does not apply to administrative fines). A director who wants to shield himself from liability can ask the board if there is a particular function which they might delegate to one of the directors and that way he would be shielding himself slightly.

5. **Have you sought indemnity?** A director can also seek an indemnity (i.e., he can try to get the shareholder of the company to give him an indemnity in the case that he has been found liable for some sanction). The difficulty with this is that a director cannot ask for an indemnity from the company itself. The law, indeed, prohibits companies from giving indemnities to their directors.

6. **Have you considered directors and officers liability insurance?** These are expensive and may not necessarily cover the director for every liability that may arise.

7. **Should you resign?** If you are a director who disagrees with what is being proposed because one feels that the decision could land them in trouble by way of personal liability. The director will need to minute to ensure that his dissent is properly recorded in the minutes of the board minutes and explain why he is dissenting from the proposal being made. Then, the ultimate thing to do would be to resign if the director was unhappy with how business was being conducted. Bear in mind that resigning does not *ipso facto* absolve the person from liability for decisions he has taken or in matters which he should have noted during his tenure. Indeed, there are some situations where it would make more sense for a director who wishes to resign to make every attempt to rectify the situation that could otherwise give rise to liability, as opposed to resigning.

One can also see what they can do vis-à-vis particular sets of duties. We have considered the general duties of directors, to be in line with these duties is the easiest thing a director can do. To begin with, these duties are common sense, good judgement duties which any director who acts with integrity and with wisdom will never be in breach of any of these duties (e.g., the duty to act in good faith, honestly, and in the best interests of the company, or the rules against self-dealing). The duty to act with care, diligence, and skill, is slightly trickier as there are both objective and standards in play. If a director is not competent or experienced enough, he is better off not sitting on the board.

With respect to the aforementioned administrative duties, many are of a company secretarial nature. To lower the risk of liability company directors can: first, engage a competent and hard-working company secretary who will know what the obligations are; second, they should monitor what the company secretary is doing, and a good idea would be to ask that person to create a list of duties and when they should be carried out, asking them for updates every few months. When it comes to administrative duties it is not particularly difficult to avoid liability, but one must remain engaged and take on a competent company secretary.

There are then certain risks associated with a company going into insolvency. A lot can be said about this, and there is in particular one risk of liability, i.e., that of wrongful trading (pursuant to article 316 of the Companies Act), and a breach thereof will arise when directors who knew or ought to have known that a company cannot avoid going into insolvent liquidation fail to take every reasonable step to protect the interests of creditors. Therefore, if a company is approaching insolvency, what needs to be done to mitigate the risk of liability goes beyond what has been said about mitigating risk. For example, the need for more regular management account being drawn up and studied, more regular meetings, more importantly the bringing in of advisors, ensuring that payments are not made unless necessary, that creditors are not distinguished between, that payment arrangements are made with creditors.

With respect to the risk of liability for breaches of health and safety legislation, this, rightly, has in the last twenty years been taken very seriously by the authorities who, if a breach is found, would take even criminal action against the directors involved. There is the fundamental obligation to provide a safe system of work and to follow some of the details in the health and safety legislation. To ensure these things, it

depends on the nature of the business being conducted by the company. It is one thing if it has no or few employees, it is another if it has many working in the construction or physical services sector. One thing which has to be done is the creation of a health and safety committee to monitor and ensure the imposition of health and safety rules. This, however, is not sufficient, and directors must ensure that the people on this committee are competent and are truly doing their jobs. If they note that improvements are possible directors must insist on them.

V. Share Capital Continued

One of the main reasons investors go for an LLC as a means of doing business is because it offers flexibility that partnerships do not. One of the ways in which this flexibility is manifested is in the form of transferrable shares. Therefore, we shall consider share transfer agreements and pre-emption rights. A share is defined as a fractional ownership of the capital of a registered company and simply put, this represents the holder's proportionate financial stake therein, known as a pro rata holding. The fact that one is a holder of a thing gives them rights and obligations over it in the sense that a person's shareholding also represents the measure of a shareholder's interest in the company and the basis of his membership rights. In one judgement delivered by the Constitutional Court in the names of ***Profs. Ganado et noe v. Dr Borg Olivier*** (15/06/1973), the Court examined the juridical nature of the rights conferred on shareholders and observed that on the one hand, a holder of shares in a commercial company is a subject of ownership and owning shares in the modern world is the way to do business. On the other hand, the shares that are owned by a shareholder causes him to become a member of an association.

Becoming a Shareholder

The Companies Act and text writers recognise three main modes of becoming a shareholder:

1. By subscribing to the memorandum of association,
2. By being allotted shares,
3. By a mode of acquisition other than original subscription or allotment.

In relation to the acquisition of shares, original subscription denotes the subscribers of the memorandum and articles of association who become the first members of the company, whereas allotment refers to a person who can also become a member by being allotted shares in the company following an issue of shares.

The Right to Transfer Shares

A shareholder has *prima facie* a right to transfer his or her shares. In fact, any restrictions on the right thereof must be stipulated in the memorandum or articles of association or in some other agreement. In general, these agreements will be referred to as shareholders' agreements. There would be restrictions in the articles of association, and it is possible for certain classes to have further restrictions through shareholders' agreements. It is of the utmost importance that there are no clashes between what the M&A stipulate and any subsequent shareholders' agreements. The ability to restrict the transferability of shares are generally justified because they give existing shareholders the legal tools to control the membership of the company. One judgement where this was reaffirmed is ***Anthony Montebello v. Alfred Darmanin et.*** (COA, 1996). *Vide* Farrar and Hannigan's work.

The Companies Act, with regard to the restriction on shares, distinguishes between private and public companies. The Companies Act, in the case of private companies, allows the M&A to contain restrictions on the transfer of shares and, in the case of private companies, it actually requires the M&A to impose such restrictions. Whereas

in the case of private companies the Companies Act expressly requires for there to be includes certain restrictions on the transfer of shares, such express requirements are not included in respect of public companies because the Companies Act is silent in this respect. The terms “transfers” and “transmission” of shares are also worth noting. These are the terminology used by the Companies Act and the former, as used thereby, appears to refer to most of the modes of disposal of the ownership of shares *inter vivos* by an agreement. By contrast, this is not the case with respect to the latter term which appears to refer to a disposal occurring upon the death of a shareholder whereby his shares devolve unto his heirs, transmission *causa mortis*. Practical examples of a disposal of shares *inter vivos* include sale, exchange, compromise, the partition of property, or a donation. The transfer and transmission of shares in LLCs are key features that determine what each shareholder can do with the shares he holds. Hence, although we keep on reiterating the fact that shares give rights to each shareholder, some of such rights can sometimes be restricted in some manner. The situation regulating the transfer of shares in Maltese company law has developed significantly over the years, and the provisions which have been included in today’s Companies Act are largely modelled on the UK Companies Act of 1985 as well as the EU Directives on company law.

With respect to the transfer of shares, a fundamental distinction exists in the Maltese Companies Act between public and private companies. In the case of the latter the Companies Act imposes an obligation on the first subscribers of the company to include some sort of restriction, no matter how minimal this can be on such a share transfer. To explain this requirement, one must understand the business environment that we find in Malta. There is a prevalence in the Maltese business world for there to be private companies that are usually family-owned and therefore the legislator wanted the members of these companies to control the entry of new members.

These restrictions often take the form of pre-emption clauses, usually found in the company’s statute. A second, less popular, restriction takes the form of the directors’ discretion to refuse to register a share transfer.

Pre-emptive clauses are defined as any rights shareholders may have to be offered shares in a company before they are made available to anyone else. These pre-emptive rights can arise on the allotment of shares, when one is transferring shares, or on transmission. A pre-emption clause means a shareholder has to offer his shares firstly to the members of a company where he is a shareholder, and only upon their refusal does he have the right to offer his shares to third parties at any price. Therefore, they have the right of refusal. In practical terms, such pre-emptive rights may be important to ensure that a shareholder’s proportion of the voting and other rights in the company, including the right to a dividend, are not diluted.

The directors’ discretion to refuse to register a share transfer must be exercised on their part in good faith because it is a logical extension of the fiduciary duties with which directors are obliged to follow. Interestingly, although the discretion of the director to refuse to register a shareholder must be exercised in good faith, the director is not obliged to give reasons for such a refusal. It goes without saying any restrictions

must be included in the company's statute in a clear and unambiguous way that must lead to no doubt and confusion.

Besides what is mentioned in the articles of association, it is possible to have a situation where shareholders, either all or some, of a particular company, can decide to draw up a shareholders' agreement. One point one must remember is that any such agreement binds only those shareholders who sign it. The practical consequence of this is that there may be a situation where the M&A only contains a pre-emption clause, whilst the shareholders' agreement enlists more rigorous rules and restrictions that must be abided by those shareholders who decided to sign such an agreement. With respect to the company's articles of association, it is a fact that many contain provisions on the allotment of shares which either exclude the statutory rights mentioned above or impose different provisions on share allotment. It is by and large agreed that no issue of shares should be made without being sure what pre-emptive rights apply under the articles and how the provisions therein relate to the current statutory provisions.

At present, the Companies Act includes no statutory provisions imposing pre-emptive rights but as a matter of practice they are often includes in the articles of association, nonetheless. With respect to shareholders' agreements, it is to be said that many such agreements include provisions restricting further the issue of shares and controlling the transfers of shares and their transmission. A shareholders' agreement will also cover many other matters and if one is being put in place for other reasons then the share transfer provisions are usually included in it. What must be avoided is having share transfer provisions in both the articles and a shareholders' agreement that are not identical, as otherwise there will be a conflict which would lead to practical problems. It is possible to have a shareholders' agreement between certain shareholders which impose stricter restrictions than what is laid down in the articles of association.

Articles 118,119,120, and 123 are the relevant sections of the Companies Act.

Article 118 on the transfer of shares or debentures states:

> **118.** (1) *Notwithstanding any provisions contained in any other law, a transfer of shares in or debentures of a company shall be made in writing.*
>
> (2) *It shall not be lawful for a company to register a transfer of shares in or debentures of the company unless a proper instrument of transfer or an authentic copy thereof has been delivered to the company:*
>
> *Provided that, without prejudice to any obligation arising under the provisions of the Duty on Documents and Transfers Act, nothing in this article shall prejudice any power of the company to register as shareholder or debenture holder any person to whom the right to any*

> *shares in or debentures of the company has been transmitted causa mortis.*
>
> (3) *This article shall not apply to shares or debentures of a company held or evidenced in a dematerialised form or represented in book-entry form as immobilisation.*

Note that it is a *sine qua non* for the transfer of shares that it be done in writing and that the company records contain the proper instrument of transfer.

Article 119 then focuses on the registration of the transfer or transmission of shares or debentures, stating:

> **119.** (1) *On the application of the transferor or of the transferee of any share in or debenture of a company, the company shall enter in its register of members or of debentures, as the case may be, the name and address of the transferee and where the application is made by the transferor the entry shall be made in the same manner and subject to the same conditions as if the application for the entry were made by the transferee.*
>
> (2) *If a company refuses to register a transfer of shares or debentures, it shall, within two months after the date on which the transfer was lodged, send to the transferee notice of the refusal.*
>
> (3) *Notwithstanding the provisions of the regulations contained in Part I of the First Schedule and notwithstanding anything contained in a public company's memorandum or articles, the directors of a public company shall be obliged to register the transfer of any shares in the company in favour of any person who has acquired those shares as a result of a judicial sale thereof.*
>
> (4) *On the application of the person to whom the right to any shares in or debentures of a company has been transmitted causa mortis, the company shall register in its register of members or debentures, as the case may be, the name and address of such person.*
>
> (5) *If a company refuses to register a transmission as is referred to in sub-article (4), it shall, within two months after the date on which the transmission is lodged, send to the person to whom the right to any shares or debentures of a company has been transmitted causa mortis, notice of the refusal.*

> (6) *If default is made in complying with the provisions of sub- articles (2) or (5), every officer of the company who is in default, shall be liable to a penalty, and, for every day during which the default continues, to a further penalty.*

This contains the obligation of every company to have an updated register of members. Unfortunately, most companies do not have one, but this failure is a serious one. Unless the transferee follows the proper procedure, the transferor can refuse. If the company is found in default, sub-article (6) lays down a penalty for every day during which the default continues.

Article 120 deals specifically with the issue of certificates, stating:

> **120.** (1) *Every company shall, within two months after the allotment of any of its shares or debentures and within two months after the date on which a transfer of any such shares or debentures is registered with the company, and within one month from the date on which any such shares or debentures transmitted causa mortis have been registered in the name of the person entitled to be registered as the holder thereof, deliver the certificates of all shares, debentures or debenture stock allotted, transferred or transmitted causa mortis to the persons entitled thereto, unless the conditions of issue of the shares or debentures otherwise provide.*
>
> (2) *The expression "transfer" for the purposes of this article means a transfer on which the relevant duty, if any, has been paid and is otherwise valid, and does not include such a transfer as the company is for any reason entitled to refuse to register and does not register.*
>
> (3) *In the case of a transfer or of a transmission causa mortis of shares the company shall within fourteen days after the date on which a transfer of any such shares is registered with the company, and within one month from the date on which any such shares transmitted causa mortis have been registered in the name of the person entitled to be registered as the holder thereof, deliver to the Registrar for registration a notice of the transfer or the transmission causa mortis stating the names and addresses of the transferees or the names and addresses of the persons entitled to the shares transmitted causa mortis, as the case may be:*
>
> *Provided that in the case of public companies whose shares are admitted to listing on a regulated market or on an equivalent market in a non-Member State or non-EEA*

State, the delivery to the Registrar shall take place within ninety days after the date on which a transfer of any such shares is registered with the company, and within ninety days from the date on which any such shares transmitted causa mortis have been registered in the name of the person entitled to be registered as the holder thereof.

(4) *If default is made in complying with any of the provisions of this article, every officer of the company who is in default shall be liable to a penalty, and, for every day during which the default continues, to a further penalty.*

It is important that if one is a shareholder, one must have a certificate that demonstrates such a fact. This provision is also rarely observed. The importance of article 120(2) is that one finds therein a definition of the term "transfer".

Articles 123, with respect to the register of members, states:

123. (1) *Every company shall keep a register of its members and shall enter therein the following particulars:*

(a) *the names and addresses of the members and a statement of the shares held by each member, distinguishing each share by its number, so long as the share has a number, and of the amount paid or agreed to be considered as paid on the shares of each member.*
(b) *the date at which each person was entered in the register as a member; and*
(c) *the date at which any person ceased to be a member.*

(2) *Where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this Act, be treated as a single member; and, unless otherwise provided in the memorandum or articles, the name of only one of such persons shall be entered in the register of members. Such person shall be elected by the joint holders and shall for all intents and purposes be deemed vis-à-vis the company to be the member of the company in respect of all the shares so held.*

(3) *The register of members shall be kept at the registered office of the company or at such other place as may be specified in the memorandum or articles.*

(3A) *Notwithstanding the provisions of this article, a company may make arrangements for the register of its members to be kept in a dematerialised form or*

> *represented in book-entry form as immobilisation with a central securities depository established in a recognised jurisdiction:*
>
> *Provided that the company shall remain responsible for the proper keeping of the register and shall keep a copy of all entries relating to registered shareholders held by the central securities depository.*
>
> (4) *If default is made in complying with any requirement of this article, every officer of the company who is in default shall be liable to a penalty, and, for every day during which the default continues, to a further penalty.*

Note the actual requirements and procedure which must be followed when it comes to the transfer of shares. Part of which is the filing of a Form T, i.e., a specimen form of notice of transfer or transmission of shares as published by the Registrar. A person can only be recognised as a shareholder for the purposes of the Companies Act if his named is entered into the register of members. Professor Muscat justifies this understanding by referring to article 2(1) of the Companies Act which defines a shareholder as a "person entered in the register of members of a company pursuant to article 123". Furthermore, the articles often provide that the transferor of a share is to be deemed to remain a holder until the name of the transferee is entered into the register of members in respect thereof. Again, Prof. Muscat remarks that unfortunately many companies do not keep a register of members and, if they do, they fail to update it.

In the case of ***S.B. Fiduciary Ltd. v. Crocodile Ltd et.*** (FH CC, 29/01/2015), the issue of who has the right to institute an article 402 action arose. Reference was made to article 127 of the Companies Act which defines a beneficial owner in sub-article (5) as *"the person beneficially entitled to the shares under a trust or a fiduciary agreement".* The court had to examine article 402(1) which referred to "any member". We have a specific meaning of the term "member" for the purposes of article 402 which is different from the general definition found in the beginning of the Companies Act. The legislator, in terms of article 402(6), extended the definition of the term member. Whilst the definition under article 2(1) reads:

> *"member", except where otherwise specifically defined, means a shareholder of a company and a partner in any other commercial partnership.*

The definition under article 402(6) instead states:

> (6) *In this article, the term "member" includes a person entitled at law to represent the interests of a deceased member, a person to whom shares in the company have lawfully devolved by way of testate or intestate succession,*

and a trustee, as defined in article 127, who holds shares in the company.

At a glance, the categories of people entitled to institute an article 402 action is far wider than the group defined in article 2(1). We also find the element of good faith which is crucial for any act done according to law. The Court held that it did not have sufficient proof that the transfer of shares from the plaintiff company to Crocodile Ltd. was duly done according to the procedure laid down in law:

Skond il-memorandum u l-articles of association tal-intimata Crocodile Limited, jirrizulta li l-ishma kollha ta` Crocodile Limited, u cioe` 2000 –il sehem huma registrati f`isem International Trust Limited u fuq l-ebda hadd iehor. Fl-istess att, jinghad li International Trust Limited tagixxi bhala licensed trustee. L-uniku direttur tal-intimata Crocodile Limited huwa Cesare Florio filwaqt li Av. Katya Azzopardi hija l-company secretary. Ma jirrizultax ippruvat illi wara li International Trust Limited ittrasferiet l-ishma, li ssemmew fil-kors ta` din il-kawza fi Crocodile Limited, lis-socjeta` rikorrenti, kien hemm registrazzjoni ta` dak it-trasferiment fir-registru tal-membri ta` Crocodile Limited skond l-Art 119 tal-Kap 386. Indirettament jirrizulta li ma kienx hemm registrazzjoni ghaliex is-socjeta` rikorrenti dehrilha li kellha tikteb lil Cesare Florio sabiex jipprezenta l-Form T. Nafu bhala fatt ippruvat li hadd mill-persuni li skond il-ligi setghu jipprezentaw il-Form T ma pprezentaha.

…

Ghar-rigward tal-azzjoni kif dedotta kontra Crocodile Limited, il-Qorti tirrileva li hija sprovvista mill-prova li t-trasferiment ta` ishma favur is-socjeta` rikorrenti fi Crocodile Limited kien registrat fir-register of members tal-kumpannija skond l-Art 119 tal-Kap 386. Hija sprovvista wkoll mill-prova li thallset it-taxxa dovuta fuq l-allegat trasferiment ta` ishma skond l-Art 120(2) tal-Kap 386.

Ladarba mhuwiex ippruvat li s-socjeta` rikorrenti tikkwalifika bhala "shareholder" ta` Crocodile Limited skond l-Art 2(1) tal-Kap 386 u allura ma tistax tikkwalifika bhala "member" ta` Crocodile Limited, din il-Qorti, minghajr l-icken esitazzjoni tghid, illi s-socjeta` rikorrenti hija ex lege prekuza milli tistitwixxi l-azzjoni odjerna.

Note the importance of following proper procedure and of having the company in good standing by duly filing and registering forms with the MBR, by paying duties, by keeping a proper register of members, etc.

In the case of ***Dr Peter Borg Costanzi noe v. Carmelo and Mario Micallef*** (COA, 27/02/2009) the validity of the share transfer agreement was questioned, that is to say, there was an action for the nullity of a share transfer agreement. The court again placed a heavy burden on the formalities of such agreements. This case dealt with a claim for the payment of a sum due by the defendant in favour of the plaintiff as consideration for shares transferred by the latter to such defendant. In this case there was a repayment program included in the share transfer agreement.

Rita Borg, as represented by Dr Borg Costanzi, was the owner of 1,999 out of 2,000 fully paid-up ordinary shares of LM1 in the company Australian Quality Imports Ltd., whilst the one share was owned by Martin Bezzina. By virtue of a private writing dated 9th June 1995, the shares were all sold and transferred to the defendant and the plaintiff transferred her shares for a consideration in the region of Lm14,000. She was paid the amount of Lm4,000 upon the signing of the agreement and there was a payment schedule for the outstanding balance. The defendant defaulted on the remainder and the plaintiff instituted an action to recover it. The defendant, however, argued that the plaintiff's claim was unfounded in fact and law based on the nullity of the share transfer agreement. They argued that they had accepted to buy the shares from the sellers on the basis of relevant information, such as the current annual turnover levels and the gross profit margin of the company, provided to them by the sellers and established in Clause H of the share transfer agreement, meaning it included a requirement to confirm these details.

The defendants argued that this information was vitiating, arguing further that the sellers of the company's shares had failed to honour their contractual obligations deriving from the share transfer agreement by *inter alia* failing to assist the defendants when they faced problems with suppliers, and also failed to introduce them to potential new clients. Plaintiffs rejected this plea, arguing that the claim for a refund was prescribed and the claim to rescind the share transfer agreement was not permissible by law.

The court of first instance accepted the plea of prescription, therefore rejecting the claim that the disputed share transfer agreement was null and void, and confirmed its validity, ruling for the plaintiff on this basis. The defendants were aggrieved by this judgement and appealed where the Court entered into the clauses related to the share transfer agreement. The Court of Appeal noted that the disputed clause in the share transfer agreement included the following: vendors undertake to cooperate with the purchaser in respect of any problems they may encounter with their suppliers and help them to be introduced to new clients. The Court, in coming to its decision, made a cross reference to Article 966 of the Civil Code that lists the basic requirements of any contracts being: concern, *causa*, consideration, and capacity. Another important Article of the Civil Code highlighted by the Court of Appeal is Article 981 which is the codification of the maxim *fraus omnia corrumpit.*

The Court applied these basic principles of civil law to the share transfer agreement in a manner that reflects the importance of such agreements stating what they intend and being clear and unambiguous. The Court held that the accountant appointed by

the defendant had meticulously examined the books of the company and had properly informed their purchase on the basis of such books provided, holding that these books where not forged in any way and reflected the truth. Regarding the annual turnover levels, the Court stated that there was no fraud or deceit and ultimately the increase or decrease in turnover depended on the persons running the business. Martin Bezzina, in fact, informed the Court that there was a lack of enthusiasm on the part of the defendants. In fact, one of the defendants was running the business part time. The court agreed that the sellers had done their utmost to help the defendants, but the rest was in their hands, and the business would only move forward with their participation and effort. Perhaps, through a lack of experience, the defendants failed to succeed. On the basis of this the Court held that there was no element of fraud in the drawing up of the STA and therefore the defendant's consent was not vitiated. There was simply an agreement between the parties and a sum due which should be paid in consideration of the shares transferred.

VI. Listed Entities

Public companies have a higher authorised share capital and must have at least two directors. Listed entities must be by force public companies, but it does not mean that any public company is a listed entity as some may opt not to list. In Malta there is only one regulated market, i.e., the Malta Stock Exchange. At face value, since it has to be a public company, if a private company decides to list on the regulated market, it is very important to convert itself to a public company as a first step, meaning this company must at least raise its authorised share capital to roughly €47,000, and raise its number of directors to at least two. Furthermore, the company must then take the suffix PLC. If one wants to list a company, it is very important to consider the capital markets rules which go over and above the minimum thresholds provided by the Companies Act. When a company wants to issue it can either issue shares or bonds. If a company wants to issue shares it means that other will become shareholders of the company and the original owners will lose, to a certain extent, their right to shareholding. With respect to incorporation and the validity of the issuer (i.e., the company who is to issue its securities on the MSE).

The normality is that when one becomes a shareholder they can pay for their shares either in money or in kind, with the latter being more challenging as it typically means that one decides what asset one wants to give to the company, a valuation report would be drafted by an expert and sent to the MBR for evaluation, and if it is agreed to the transfer must be made in five years. Normally, however, shares are bought through a stockbroker with cash. The value of shares on the open market can rise and fall through the market forces of supply and demand.

Bonds can be secured or unsecured. Bonds are simply loan capital from third parties instead of from a bank. It is the same concept that applies, however. When one issues bonds, it means that the person who buys them does not become a shareholder, but a bondholder. Secured bonds have more of a chance of paying out if the company goes into liquidation. Unsecured bonds are sometimes required by the MFSA to have a guarantor alongside the issuer who will pay for the bonds if something goes wrong.

A private company can never issue shares or bonds to the public, a limitation imposed by the Companies Act. The CMRs specify that the issuer (other than a Public Sector Issuer) must be duly incorporated or otherwise validly established according to the relevant laws of its place of incorporation or establishment.

EU passporting rights mean that once one submits the necessary documentation to the MFSA for their authorisation and they accept that the company would issue the securities on the regulated market, at that moment in time the issuer will get the right to also issue on another regulated market of the EU. A company could also be duly incorporated in another EU MS and decide to list on the MSE. Primary listings mean the scrutinization would have happened in Malta whilst secondary listings mean they would have been scrutinised in another EU MS. A company must merely send the authorisation documentation to the secondary market State to be accepted.

With respect to the issued share capital, the normality is that the authorised share capital and issued share capital are of the same amount. Ultimately, a high amount of

authorised share capital and a lower issued share capital, the annual returns would be high merely for the fact of this lower issued share capital. The issued share capital is the amount that the company actually uses. Raising the ASC requires an extraordinary resolution whilst raising ISC only requires an ordinary resolution. That €47,000 is the minimum with the CMRs imposing a minimum of €1,000,000. If a company wants to list its securities, the paid up issued capital must be at least €250,000.

Another term used by the CMR is market capitalisation which simply means the value of the company on the open market and the company's perception of its future prospects, meaning that market cap can change on a daily basis. Therefore, this terminology is very different from that used for equity, which simply refers to a statement of a company's assets minus the liabilities, and simply refers to the new profit that would remain if the company was sold or liquidated at fair value. Equity is therefore fixed and does not fluctuate frequently. With respect to market cap the CMRs impose a minimum of €1,000,000 excluding preference shares and if it cannot be determined the capital and reserves must be at least that amount.

With respect to employees' shares, certain companies as an incentive offer shares to their employees. With respect to preference shareholders, the CMRs state that these have a right to vote at any general meeting of the issuer which is convened for the purpose of:

1. Reducing the capital of the issuer, or
2. The winding up of the issuer, or
3. Where the proposition to be submitted directly affects their rights or privileges, or
4. When the dividend of their shares is in arrears by more than 6 months.

With respect to reduction of share capital there is a specific procedure imposed by the CA. In general, banks may ask for a higher number of shares to offer a loan. However, when one is raising the number of shares then the annual return would be higher, leading to higher expenses. Therefore, it is common practice to reduce the share capital after the loan is secured so long as it is not reduced below what is owed to creditors. Usually, a company informs the Registrar who imposes a published period of three months in which any creditor can object. With respect to winding up in general, dissolution is when the company wishes to stop functioning, whilst winding up is the process of closing the company down. The winding up process can either be triggered by the courts, or by the members themselves.

Shareholders' funds, as the term implies, refer to the amount of equity that belongs to shareholders and includes outstanding shares, paid up capital, retained earnings, and treasury stocks, and this amount must be at least €600,000. A treasury stock is a share bought back by the company. Issued share capital refers to both treasury stocks and those in the hands of shareholders. By contrast, the term outstanding shares refers to all shares minus treasury stock.

With respect to directors, the CA imposes a minimum of two and does not differentiate amongst different classes of shares. Irrespective of the type of director, they all fall

under the same category if in the eyes of everyone that person can take decisions that can financially impact the company. By contrast, the CMRs differentiate between executive and non-executive directors. The CMRs state that a company must have both a board of executive directors and a board of non-executive directors. Directors can either be *de facto* or *de jure.* The CMRs also state that corporate directors are not allowed. The election of directors takes place every year and all except the managing director shall retire from office once at least every three years but can be eligible for re-election. The company must give at least 14 days' notice to shareholders to submit the names for the election of directors and the notice of who the issuer is proposing for director as well as the letter of acceptance for the candidacy.

When one is appointed as a director the same rules as to obligations apply; meaning article 136A applies for sure, as well as articles 143-145. Bear in mind that when one is not officially a director, fiduciary obligations still apply. Articles 136A specifies that directors are responsible towards the company. CMRs make specific reference to the Enlightened Shareholder Value (ESV) and Corporate Social Responsibility (CSR) principles. The latter does not feature in any provision of the CA, unlike the latter, but only features in the CMRs. Article 172 of the UK Companies Act 2006 they have already included reference to other creditors, giving it an element of CSR, but this was never introduced for local companies which are not listed. In line with the CSR principle, it is very important to consider the ESV in tandem.

Institutional shareholders are simply banks or custodians that can hold a larger number of shares than private individuals and can invest with them on behalf of clients. Banks can be referred to as credit institutions as they are banks regulated by the Banking Act. The term financial institutions, however, includes everyone who deals with financial services, including therefore banks. Apart from what we have seen, there are other committees which have to be elected per the CMRs which are not normally part of companies:

1. **The remuneration committee:** This handles the remuneration policy for directors and senior executives. This committee is composed of non-executive directors who have no personal financial interest other than a shareholding, with the chairman having no interest whatsoever. The committee shall prepare a report to be included in the annual report which shall provide information of its membership and activities. Principle 8 of the Corporate Governance Code states that the board of directors *"should set up formal and transparent procedures for developing policies on executive remuneration and for fixing the remuneration packages of individual directors".* Remuneration committees should avoid paying more than is necessary to secure the executive directors with the appropriate skills and qualities. The remuneration committee should also carefully consider what compensation commitments would be involved in the event of an early termination of the appointment of directors. The main duties of the remuneration committee are:
    a. To make proposals to the board on remuneration policy for executive directors,
    b. To make proposals to the board on the individual remuneration to be attributed to executive directors, ensuring that they are consistent with

the remuneration policy adopted by the company and the evaluation of the directors concerned,

c. To monitor the level and structure of remuneration of the non-executive directors on the basis of adequate information provided by the executive or managing directors,
d. To prepare a report in the annual report about its activities, providing information regarding its membership, the number of meetings held, the attendance over the year, and its main activities.

2. **The nominations committee:** Shall be composed entirely of company directors, the majority of which would be non-executive. An independent member will chair. This committee oversees a formal and transparent procedure of the appointment of new directors of the board. The nomination committee shall propose board candidates and periodically assess the structure, size, composition, and performance of the board and also make recommendation to the board related to changes. This committee's third function is also to consider proper succession planning. Finally, the committee reviews the boards policy for the selection and appointment of senior management.

With respect to winding up the same rules apply, however in these scenarios the CMRs state that on the voluntary liquidation of an issuer no commission and fees shall be paid to the liquidator unless approved by the shareholders.

With respect to alterations to the M&A, in most case an extraordinary resolution is required. When the company is listed, the M&A can only be changed with the approval of the MFSA, in combination with the extraordinary resolution.

The documentation to be prepared by the issuer. When an issuer is going to list securities for the first time, we call it an Initial Public Offering (IPO). The issuer must prepare a prospectus and any supplements according to the 2019 Prospectus Directive. The list of documentation to be submitted to the MFSA is the following:

1. A complete application that is provided by the CMRs and also the payment of any relevant fees,
2. The prospectus and any supplements,
3. One copy of the issuer's audited annual accounts of the last three financial years,
4. When the applicant forms part of a group of companies, the applicant must also provide the consolidated accounts of the entire group for the last three financial years,
5. The financial accounts for the last three financial years for any guarantor, if any,
6. Any formal notices that are also provided by the CMRs,
7. A letter in line with these rules which is referred to the omission of information,
8. A completed and signed directors' declaration,
9. A certified copy of the M&A,
10. Any information that must be provided by a sponsor,
11. Any sanctions that where provided,

12. A valuation report (when we have a property company or when the issuer wants to issue securities secured on property) as compiled by an expert, clearly showing the properties included.

With respect to the sponsor, they are a person who is the intermediary between the authority and the prospective issuer. Being an intermediary means the person must be independent of the issuer, meaning they must work more closely with the MFSA than the issuer. The issuer must retain copies of all of these documents for at least five years.

The essential purpose of the prospectus is to convey factual information about the business in words and figures as a basis on which to gain information of the issuer and its proposed activities. The prospectus must also include a summary which, in a concise manner and in non-technical language, provides key information in the language in which the prospectus was originally drawn up. The prospectus can also be composed of different documents and the normality is for it to be divided into the registration documents and the securities note. In the registration any information on the issuer per se will be included, for example, the risk factors which can ultimately lead to its winding up.

By contrast, the securities note will provide details with respect to the securities which the issuer wishes to list. For example, the distribution and allotment policy, the status and ranking of bonds and bondholders, any interest rate, yield, pricing, how the bonds will be pay for, redemption and purchase, and transferability. The registration document may change from one issue to another, but the securities note will most definitely be different. For the sake of clarity, as an issuer, one can issue either or, or both. The information about the audited annual accounts is also highly important. When a group of companies is involved the parent company would hold a large number of trading companies which would be structured in such a manner that each company is formed for a specific project. When one has a company which is new and therefore does not have the three-year financial history, the MFSA will still allow it to issue by either looking at the consolidated accounts or by asking the guarantor from the group to make good for this lack of audited financial accounts.

When this documentation is provided it does not necessarily mean that the bid is automatically accepted. Once the company lists, it does not mean that one cannot delist, in the sense that an issuer can opt to remove itself from the MSE through a process. Also, if the company does not abide by the CMRs the MFSA can cancel the listing. The CMRs list the responsibilities of the sponsor which are owed to the MFSA, and the sponsor is only not needed when the issuer is from the public sector. The sponsor must be in possession of a Cat-2 or Cat-3 license pursuant to the Investment Services Act, must hold not more than 10% of the issuer, and must have adequate resources to fulfil its obligations. Multiple sponsors can be appointed and where this is the case it is important to point out which obligations fall under each sponsor. The issuer can also terminate the sponsor relationship, and another must be appointed for the listing to continue.

When the issuer is from the public sector, as defined by the CMRs, they provide an equivalent offering document and are exempted from the need for sponsors. The EOD is simpler than the registration and securities document and does not require the financial disclosures of other listings.

VII. Market Abuse

The continuing obligations as held in Chapter V of the CMRs come into play when a company decides to list on the MSE only. Since shares can be listed on the MSE we can have market abuse, i.e., the making use of certain information or arrangements to ensure a profit. Market abuse, in Malta, was always somehow regulated and illegal as we had the Prevention of Financial Markets Abuse (PFMA) Act enacted well in the past. In the beginning, the EU decided to enact the Market Abuse Directive I in 2003 which only directed for very basic information. In the early stages the EU legislates through a base Directive and builds on it with Regulations. In 2009, the financial crisis took hold and the EU realised that it was not doing enough, enacting the Market Abuse Regulations and the Market Abuse Directive II. MAR provides for basic definitions and also for administrative penalties. As may be appreciated, being a regulation makes it directly applicable in all EU MSs. MAD II provides for the criminal sanctions and the EU decided to enact it for the simple reason that after the 2009 financial crisis the EU learned that not all MSs criminalised market abuse. All of this transposition was done by the PFMA Act. ESMA technical standards are to be read in conjunction with the PFMA, providing further definitions and forms to enhance MAR. These forms are to be filed with the MFSA as the competent authority. The EU guidelines should also be considered. Not all MSs are bound by guidelines, but they remain applicable in Malta. One should also consider the subsidiary legislation under the PFMA that applies the Directive that allows for employees to report their employers. The idea of creating and ensuring that market abuse is illegal is for the simple reason that the EU is always pushing to create a genuine internal market that ultimately results in more economic growth and job creation.

Market abuse applies for all financial instruments which must be admitted to the regulated market in the EU to what a Multilateral Trading Facility (MTF) or Other Trading Facility (OTF). The CMRs do not apply to these two trading venues, which are instead regulated by the MiFIR and MiFID. For the sake of clarity, “emission allowances” are limits to the amount of carbon dioxide that can be emitted, and if this limit is reach the remainder must be bought. A company that does not reach this limit can sell its emission allowances.

There are three offences of market abuse:

1. **Insider dealing:** When a person is directly or indirectly involved with a particular issuer and has material non-public information (MNPI) with which he decides to act for his own benefit or for the benefit of a third party. Take, for example, a director who attends the AGM and before it prepares the annual report. The director knows that the shares of the issuer will be negatively impacted based on the contents of the report, meaning he has non-public information which would materially impact the price of the shares if the information was publicly known. This director then decides to sell his shares before the report is published, meaning he acted upon inside information, thus committing insider trading. The regulations provide for *“persons discharging managerial responsibilities”* which includes any person with an administrative, management, or supervisory role with the issuer, or a senior executive who has access to the information of the issuer directly or indirectly. This includes the

company secretary as in today's world the normality is that they are legal professionals or accountants who could easily understand the MNPI presented to them.

Therefore, when a company secretary is not fulfilling their obligations, the MFSA asks the company to replace them at pain of cancelling their licensing. This basic definition of persons discharging managerial responsibilities is provided as is because of the distinction between one (as is the case in Malta) and two-tier boards. Two tier boards have both a board of directors and a board of employees. Any person who could somehow have access to MNPI is someone discharging managerial responsibilities. Insider lists come in two types: permanent and temporary. The distinction between the two is that on the former the issuer must list any person who may have access to MNPI. This list must be sent to the MFSA so that when it carries out its daily checks it can see whether any person with access to MNPI acted with the issuer. It does not follow that any person with access to MNPI who buys or sells securities of the issuer is guilty of insider dealing. On the temporary list those persons who have access to insider information for a limited period of time are listed. Take, for example, auditors. It shall be seen how in the majority of cases persons were found guilty. It is of paramount importance that these lists include the ID card numbers of those named.

2. **Unlawful disclosure of inside information:** This means that the person who has access to inside information passes it on to third parties, with the intent for the person to make use of and profit from this information. When this MNPI is given the person would not be found guilty if it was given to fulfil one's duties. Take, for example, a director with access to MNPI whose friend has shares in the company. The MNPI indicates a rise in profitability and the director advises his friend to purchase more shares. One would not be guilty, however, if one passed that MNPI on to the authority in order to fulfil a legal obligation.

3. **Market manipulation:** This happens when one gives a false impression of the market. To do so, one does not necessarily have to have access to MNPI but can simply agree between oneself and another. When one wants to buy or sell shares in an issuer, they go to a licensed stockbroker who matches the order to a third party. As a broker, they can also act on the basis of nominee accounts, but as an authority the MSFA has the right to ask for the name of the person behind the account. One can still have access to MNPI and decide to manipulate the market with others.

One can ensure that one is not guilty of these offences by not dealing two months prior to the publication of the report unless that one can prove that one can only fulfil a legal obligation by selling one's shares at that specific time. However, if one has other assets, one cannot argue that one wished to fulfil one's obligation using the funds from the share sale. To minimise this risk, there are managers' transactions. ESMA technical standards provide a particular form that shows that when one acts in the issuer with a managerial responsibility, one must fill in this form indicating the date of the transaction, the number of shares, and the price, and send it to the MFSA. In

relation to these forms, they must be filled in not only by the persons who themselves have a managerial position in the issuer, but also by persons closely associated to them, as the result of the offence of the unlawful disclosure of MNPI. The Regulation states that persons closely associated refers to any spouse or partner as defined in our national law, dependent child under the age of 18, persons living in the same household at least one year before the date of the transaction, and legal persons who are directly or indirectly controlled by any of the mentioned persons.

Market sounding, as mentioned in MAR, was already being carried out before the introduction of the Regulation. It means that the issuer, or a third party acting on their behalf, might ask for certain people to attend a very specific meeting with an intent to gauge information about future securities that may be admitted to listing. In practice, a company may be interested in issuing more shares but before going through the process thereof, investors are approached, and their interest is assessed. On the basis of market sounding, during that meeting MNPI is being given to these specific investors and this information would be given only to a very particular group. To ensure that these investors do not act on it, there is a particular form provided by the ESMA technical standards for the issuer to fill in specifying exactly what information would be provided to these investors. By contrast, each investor must fill in another form, provided by the guidelines, and the investor writes down what information he has received. If the same information is on both forms the issuer will sign the form of the investor and vice versa. If the investor then, irrespective of the MNPI, acts in the issuer, they cannot be found guilty of insider dealing. If the issuer and the investor were not to agree on what inside information was passed on, the issuer and investor will each fill in their own forms, signing their own this time. If the authority may think that either one may have carried out any form of market abuse the forms and any other circumstantial evidence will be assessed.

There are times during the early stages of negotiations where it would make sense for an issuer to delay publication of MNPI to not mislead the public in their best interests. This decision is taken by the issuer on its own. However, when the issuer is a credit institution, delaying the publication of MNPI is also a decision based on what the issuer thinks fit, but, in such scenarios, it is very important to ask for approval by the MFSA because at that stage we are considering institutions which can heavily impact the financial stability of the country.

If one is found guilty of market abuse, there are administrative penalties and criminal sanctions. It is possible that these administrative penalties are also consider criminal sanctions for the purposes of *ne bis in idem.* Article 17(2) of the PFMA provides the following:

> (2) *An order by the competent authority under this article may require anything to be done or be omitted to be done, or impose any prohibition, restriction or limitation, or any other requirement, and confer powers, with respect to any transaction or other act, or to any assets, or to any other thing whatsoever. Without prejudice to the generality of the aforesaid, an order may:*

> (a) *require the cessation of any practice that is contrary to the provisions of this Act, the Market Abuse Regulation, any rules and, or regulations issued thereunder.*
> (b) *require the suspension or discontinuance of trading of the financial instruments concerned, including in particular a suspension or discontinuance of trading in exercise of the powers assigned to the competent authority by articles 17 and 18 of the Financial Markets Act.*
> (c) *give effect to a temporary prohibition of professional activity, in particular in the exercise of the powers assigned to the competent authority by article 7 of the Investment Services Act as applicable; and*
> (d) *require the person responsible for the infringement to desist from a repetition of that conduct.*
> (e) *request for the disgorgement of the profits gained or losses avoided due to the infringement as far as they can be determined.*
> (f) *contain a public warning which indicates the person responsible for the infringement and the nature of the infringement.*
> (g) *require the withdrawal of the authorisation of an investment firm.*
> (h) *place a temporary ban on the person discharging managerial responsibilities within an investment firm or on any other natural person, who is held responsible for the infringement, from exercising management functions in investment firms.*
> (i) *place a permanent ban on the person discharging managerial responsibilities within an investment firm or on any other natural person, who is held responsible for the infringement, from exercising management functions in investment firms only in the event of repeated infringements of Article 14 or 15 of the Market Abuse Regulation.*
> (j) *place a temporary ban on the person discharging managerial responsibilities within an investment firm or on any other natural person, who is held responsible for the infringement, from exercising management functions in investment firms.*
> (k) *impose a temporary prohibition on the exercise of professional activity.*

Pecuniary administrative penalties are also possible, stating that a person found guilty of market abuse can be suffer a pecuniary sanction of at least three times of the profits gained or losses avoided as the result of the infringement as far as can be determined whereby in relation to the main offences of market abuse, the administrative sanction

can be up to €5,000,000. If a legal person is found guilty of this offence, the administrative pecuniary sanction shall not exceed €15,000,000 or 15% of the total annual turnover of such legal person, according to the last available accounts, if found guilty of any form of market abuse, and in the other instances, therefore not found guilty of the three main offences, up to €2,500,000 or 2% of the total annual turnover according to the last financial accounts. For the least problematic cases, if found guilty, one can pay up to €1,000,000. As has been said earlier, when the MAR was being drafted, as Malta, we objected to these high administrative penalties because: first, our market is not as highly liquid as those of other countries; second, companies in Malta do not make these kinds of profits. When determining the type and level of the administrative sanction to be imposed, the MFSA must look at the gravity and duration of the infringement, the degree of responsibility of the person responsible, the financial strength of the person responsible for the infringement, the importance of the profits gained or losses awarded by the person responsible (insofar as it can be determined), the level of cooperation of the person responsible for the infringement with the competent authority without prejudice to the need to ensure the disgorgement of profits gained or losses avoided by that person, previous infringements by that person, and measures taken by the person responsible for the infringement to prevent its repetition. The sanction must clearly specify how and on what basis it was calculated.

One can also be found criminally liable and if one is accused one will have the issuance of a freezing order, meaning that all of one's assets, present and future, will be frozen until the delivery of the final judgement, at which point it will be converted into a confiscation order. Persons subject to freezing orders are given a stipend with which to live. When one is suspected of having committed market abuse, the first order issued is a monitoring order where the authorities monitor the suspects bank accounts without their knowledge. The AG can also issue an investigation order, meaning they can get information from any interested party to see whether the suspect can be accused. Together with the investigation order, the normality is to issue an attachment order because it might tip off the suspect if they are being investigated. When an attachment order is issued not all assets are attached, such as wages and pensions; however, it can be issued up to a maximum of one year. If the MFSA believes one could be found liable, its information is passed onto the police who will decide with the AG on any orders and the possibility of pressing charges. If one is found guilty of market abuse, the law stipulates that on conviction one can be liable for a fine (*multa*) or not less than €5,000 and not exceeding €5,000,000, or up to three times the profit made or loss avoided by virtue of the offence, whichever is greater, or to imprisonment for a term not exceeding six years, or both. As of March of 2023, there has yet to be a successful market abuse conviction, although administrative pecuniary penalties have been given.

With respect to administrative penalties the MFSA issues it and if the person does not agree they can appeal to the Malta Financial Services Tribunal. One such case was ***Christopher Pace v. MFSA*** (MFST, FST 3/2009, 21/10/2020) and that of ***James Blake v. MFSA.*** In the case of the former, the Tribunal went into great detail of the *ne bis in idem* principle and stated that the administrative penalty does not constitute as such a criminal penalty because the MFSA is not a court of law. In this case, the Tribunal also states that insider dealing must not be carried out with full knowledge of

the facts, and therefore there must not be a mental element because in reality the prevention of market abuse is there to ensure full integrity of the community and investor protection. They also referred to article 6 of the ECHR and the ECtHR which stated that when an accused makes use of inside information for his own benefit, it is automatically presumed that the person had full knowledge of the facts meaning it is therefore up to the accused to prove his innocence.

Jeffrey Skilling, in relation to the ENRON Corporation, hid the company's dire financial status and dumped €60,000,000 worth of ENRON stock before resigning. R. Foster Winans, the Wall Street Journal columnist found himself facing the scrutiny of the watchdog when he gave information of his upcoming articles regarding certain stocks to stockbrokers, earning thirty-one thousand dollars in the process. the MAR speaks of investment recommendations and states that if one wants to write anything they must indicate their interest in the particular issuer. Martha Stewart, a TV personality, was also convicted of having acted on an illegal tip from her stockbroker, selling her stocks before the MNPI came to light. With respect to market manipulation, *vide* the cases of JP Morgan Chase where it was ultimately accused and found guilty of giving false information to the public about itself, and that of Montgomery Street Research wash trading.

VIII. The Protection of Minority Shareholders

Sources

Most important document to look at is the memorandum and articles of association to see when the memorandum was drafted, what kind of safeguards were induced to ensure certain minority rights are at full protection. One of the most important ways of giving protection to a shareholder is to ensure that such shareholder is represented on the board of directors of the company. You ensure that the shareholder is given representation on the board of directors by having classes of shares with each class of shares you attach certain rights to each class of shareholders and one of the rights you will give to the class of rights is the right to appoint a director. The first directors of a company are appointed by giving listed in the memorandum and articles, since the law has been amended the directors also have to signify their consent that they are appointed as directors. Subsequently, if a director resigns, a new director is appointed by the shareholders. Directors are removed there is a section which deals with this which is article 140, it tells you that a simple majority of shareholders can remove a director.

Why does it make a difference to have classes of shares? Why do you afford protection of minority shareholders by giving classes of shares?

By compartmentalising the shares and attaching certain rights to a class of shares, the right to appoint a director, you are taking away the right to appointment of the director representing the minority shareholder out of the annual general meeting and assigning it to a meeting of that particular class of shareholders. If you have a company where 66% belong to shareholder A and the 33% belong to shareholder B who wants to appoint 2 directors whom he likes. If you divide your share capital into a class of shares that will entrench the right to that minority shareholder.

The fact that you have divided the share capital into different classes of shares and found a way of enduring does not do away with the effects of article 140 where it applies notwithstanding anything found in the memorandum and articles. The whole issue is that removal was it motivated by good faith or not? The use of classes of shares is not only there to ensure that you are represented, but you can also ensure that certain decisions taken by the company have the adhesion of minority shareholders as well, this is done by drafting a memorandum in such a way that such decisions require the consent of different classes of shareholders. You can say that certain reserved matters require a majority.

If you have a company and it has one asset, can the directors of that company dispose of the only asset of the company?

The directors are omnipotent, and they can do anything which is not prohibited to them in virtue of the companies act or the memorandum and articles, unless you take away this right in the way you enact the memorandum and articles. They have to do it in good faith. The directors can dispose of this land, and the company will have no assets. You can avoid this by drafting the memorandum by having certain reserved decisions whereby they are not in the hands of the directors but the shareholders. The

fact that you have passed on the decision onto the shareholders does not give the option to the minority shareholder because it does not have sufficient strength. Therefor you need what is called a qualified majority, raised the threshold for the passing of certain decisions to such an extent to ensure that the minority shareholder cannot be excluded by that decision. This same raising of the threshold is normally the same reason used for the passing of extraordinary resolutions.

Why is it dangerous for a minority shareholder, if that passing of an extraordinary resolution requires a simple majority?

Then the minority shareholder is totally excluded from those decisions. In an extraordinary resolution, it is used for an increase in share capital. It is dangerous to allow an increase in share capital because if you are a minority shareholder and the majority can pass where they are going to increase the share capital, your shareholding is diluted. There is an even more dangerous thing, to amend the memorandum and articles you need to pass an extraordinary resolution, a year down the road the majority shareholder can simply pass an extraordinary resolution and changes the articles the way he wants. That is why it is crucial to ensure that an extraordinary resolution cannot be passed unless there is the consent of the minority shareholder.

Analyse the memorandum and articles very well because that is where you are going to find most protection when you come to advise a minority shareholder. Besides this, there are various articles in the companies act that gives protection to a certain degree of minority shareholders. According to Article 81, no member of a company can be forced to buy more shares than what he originally had agreed upon. Nothing can compel me to subscribe to more shares:

> **81.** *Notwithstanding anything in the memorandum or articles of a company no member shall be bound by any alteration made in the memorandum or articles after the date on which he became a member if and so far as the alteration requires him to subscribe for more shares than the number held by him at the date on which the alteration is made, or in any way increases his liability as at that date to contribute to the share capital of, or otherwise pay money to, the company:*
>
> *Provided that this article shall not apply in any case where the member agrees in writing, either before or after the alteration is made, to be bound thereby.*

Does this give you protection?

Pass a resolution to increase the share capital and at the stage you are compelling the minority shareholder or else if he does not do so he will end up being seriously diluted.

***Renald Micallef vs Information Technology Services Limited* (24/10/1996 (this refers to article 81))**
With pre-emption rights, if a shareholder is going to sell his shares, then he has to offer his shares first to the shareholders. even if there is going to be a fresh issue of shares, the freshly issued shares must firstly be offered to the shareholder who have a right to subscribe there to as the shareholders. In this case there was an attempt to dilute the shareholding of renal Micallef by passing a decision to remove the ore emption rights of existing shareholders on a fresh issue and to offer them to certain specific shareholders excluding Renald Micallef. Therefore, he went to court to stop this from happening because it was unfair.

Article 131 provides for the right for any shareholder to receive a notice of a general meeting. It is a general principle that every shareholder must be given notice of a meeting.

> **131.** *The following provisions shall have effect as far as the articles of a company do not contain other provisions in that behalf-*
> (a) *notice of any general meeting of a company shall be given to every member of the company and shall be served in the manner in which notices are required to be served by the First Schedule.*
> (b) *two members personally present shall be a quorum.*
> (c) *any member elected by the members present at a meeting may be chairman thereof.*
> (d) *every member shall have one vote in respect of each share, or each euro of stock held by him unless otherwise provided in the terms of issue of such shares or stock.*

However, there is a weakness, so to speak, because if one had to look at Article 34 of the First Schedule of the Companies Act without the due attention, the consequences are non-existent, which is why one should not rely on the standard articles found in the first schedule:

> **34.** *The accidental omission to give notice of a meeting to, or the non-receipt of notice of a meeting by, any person entitled to receive notice shall not invalidate the proceedings at that meeting.*

Article 129 grants a right to minority shareholders who have at least 10% of the shareholding of a company to request that a general meeting will be convened, stating:

> **129.** (1) *The directors of a company shall, on the requisition of a member or members of the company holding at the date of the deposit of the requisition not less than one-tenth of such of the paid up share capital of the company as at the date of the deposit carried the right of*

> *voting at general meetings of the company, forthwith proceed duly to convene an extraordinary general meeting of the company.*
>
> (2) *The requisition shall state the objects of the meeting and shall be signed by the requisitionist or requisitionists and deposited at the registered office of the company and may consist of several documents in like form each signed by the requisitionist, or if there is more than one requisitionist in any one document by all of them.*
>
> (3) *If the directors do not within twenty-one days from the date of the deposit of the requisition proceed duly to convene a meeting, the requisitionist or requisitionists may convene a meeting in the same manner, as nearly as possible, as that in which meetings are to be convened by the directors, but a meeting so convened shall not be held after the expiration of three months from the date of the deposit of the requisition.*
>
> (4) *Any reasonable expense incurred by the requisitionist or requisitionists by reason of the failure of the directors duly to convene a meeting shall be repaid to the requisitionist or requisitionists by the company, and any sum so paid shall be due personally by the directors who were in default and may be retained by the company out of any sums due or to become due from the company by way of fees or other remuneration in respect of their services to such of the directors as were in default.*

Its usefulness is because if there is any matter which is being done by the majority shareholders which is prejudicing the minority shareholder then they can bring that matter for discussion before the highest organ of the company. the majority shareholders will have to either partake in that meeting or not at all or vote against any motion that is being proposed. You use this article, e.g., a company where you have a majority shareholder who owns 70% and a minority shareholder who owns 30%. The company has an asset, and the majority shareholder is leasing it out to a member of his wife's family which is below market rate. As a minority shareholder I am livid at the fact that the company can make much more profit, but it is not due to this low rental rate. If I am acting for the minority shareholder, I would convene a general meeting and propose a resolution where I suggest that the company is to rent out its property at the highest possible rate. That is going to compel the majority shareholder to commit himself somehow, he has to take some position. He can refuse to attend the meeting, if so, when I institute litigation against him, I will show the court that I suggested this resolution which is in the best interest of the company, and he refused to attend this meeting will show that court that the majority shareholder is not in good faith at all. If he attends the meeting, he will have to vote, he can vote in favour, against or abstains.

Take, for example, one acting for a minority shareholder who suspects that the way the company is being run is not correct, and when one comes to approve financial statements, one does not want there to be a vote that one has approved those statements. In this scenario, one shall abstain.

Under Article 129 one is putting the wrong doer on the spot and that position will be used in an eventual court case that one will bring against that shareholder. With respect to the mechanics of this article, the request to convene the general meeting must be done by at least 10% of the shareholders, must be signed, and be deposited at the registered office. The directors of the company have 21 days to convene the meeting. If they do not do anything about it, the law gives the shareholders who would have requested the meeting – the requisitionists – the right to convene the meeting themselves. It must be held with 3 months form when it is requested. Any expense incurred by the shareholders who requested the meeting to convene the meeting will be reimbursed to them by the companies act.

If one does not have 10% of the shareholding of the company, or if the majority shareholders through the directors are refusing to intervene, Article 132 states:

> **132.** (1) *If for any reason it is impracticable to call a meeting of a company in any manner in which meetings of the company may be called, or to conduct the meetings of that company in the manner prescribed by the articles or this Act, the court may, either on its own motion or on the demand of either of the parties to the proceedings during the course of such proceedings or, in the absence of any proceedings, on the application of any director of the company or of any member of the company who would be entitled to vote at the meeting, order a meeting of the company to be called, held and conducted in such manner as the court thinks fit, and where any such order is made, may give such ancillary or consequential directions as it thinks expedient, including a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.*
>
> (2) *The provisions of sub-article (1) shall also apply to the calling of meetings of the board of directors of a company, if the court considers that the circumstances justify such course of action.*

In the case of ***PMS vs X – Jaguar Limited***, 90% of the shareholding belonged to a physical person, whilst the remaining 10% belonged to PMS limited. The physical persons passed away and ended up in a situation where no general meeting could be convened, and the 10% shareholders were stuck. Plaintiff applied to the court in terms of article 132 so that a general meeting could be convened and asked that there would be no quorum requirement for this meeting and a simple 10% of the shareholders

would be sufficient to pass a resolution in order to be able to appoint a new director. The court acceded to this request.

Vide the case of ***Damien v. Mark Schembri*** (article 132).

Another article which is there to assist is article 133. Article 133(1) gives a right to the minority shareholder. One of the rights that cannot be done away with – sacred right:

> **133.** (1) *Notwithstanding anything contained in the memorandum or articles of a company, any member entitled to attend and vote at a meeting of the company or at a meeting of any class of members of the company shall be entitled to appoint another person, whether a member or not, as his proxy to attend and vote instead of him, and a proxy so appointed shall have the same right as the member to speak at the meeting and to demand a poll.*
>
> (2) *The appointment of a proxy shall be in writing.*
>
> (3) *In every notice calling a meeting of a company there shall appear with reasonable prominence a statement that a member entitled to attend, and vote is entitled to appoint a proxy and that a proxy need not also be a member. If default is made in complying with this sub-article, every officer of the company who is in default shall be liable to a penalty.*
>
> (4) *A provision in a company's memorandum or articles shall be void in so far as it would have the effect of requiring an instrument appointing a proxy, or any other document necessary to show the validity of, or otherwise relating to, the appointment of a proxy, to be received by the company or any other person more than forty-eight hours before a meeting or adjourned meeting for that appointment to be effective.*
>
> (5) *A company shall not issue at its own expense to some only of the members entitled to be sent a notice of a meeting and to vote thereat by proxy, invitations to appoint as proxy a person or one of a number of persons specified in the invitations. If default is made in complying with this sub-article, every officer of the company who is in default shall be liable to a penalty:*
>
> *Provided that an officer shall not be liable to a penalty by reason only of the issue to a member at his request in writing of a form of appointment naming the proxy, or of a list of persons willing to act as proxy, if the form or list is*

available on request in writing to every member entitled to vote at the meeting by proxy.

(6) *The provisions of this article shall apply to meetings of any class of members of a company as they apply to general meetings of the company.*

Paul Hili v First Food Franchise Limited
Time where shareholders of first foods wanted to remove Paul Hili from being a director, they sent a notice of a general meeting to remove him as a director. In the notice of the GM, they failed to put in a proxy form and informing him that he has a right to inform a proxy. They withdrew the meeting right away and reissued a notice. when you use a proxy, either if you unable to attend or even though you are available you might not want to face the other shareholders or could be in a situation where the subject is possible technical and you might want to have an expert in the field to defend your behalf or you might want a lawyer to raise certain issues. Just like you can ask the court to convene a meeting and you can also ask for the appointment of a director. An important right given to you is the right to request the appointment of an auditor. If the majority shareholders refuse to appoint an auditor and your rights as a minority shareholder will be at severe prejudice.

At the general meeting there must be the presentation of the financial statements whereby they have to be audited and make sure that it will give a true and fair view of what is going on. Only opportunity as a shareholder to look at the internals of a company to see how the company is progressing. If the majority shareholder does not appoint an auditor, then you have a right to request the court to appoint an auditor (section 133 (4)). The registrar of a companies, if a company falls 2 years in filing its financial statement they will be struck off. If you are not in compliance with the rule that you have to have a general meeting within 15 months, you will be struck off.

Article 161 on the statement by person ceasing to hold office as auditor states the following:

161. (1) *Where an auditor ceases for any reason to hold office, he shall deposit at the company's registered office a statement of any circumstances connected with his ceasing to hold office which he considers should be brought to the attention of the members or creditors of the company or, if he considers that there are no such circumstances, a statement that there are none.*
(2) *In the case of resignation, the statement shall be deposited along with the notice of resignation; in the case of failure to seek re-appointment, the statement shall be deposited not less than fourteen days before the general meeting at which auditors are to be reappointed; in any other case, the statement shall be deposited not later than the end of the period of fourteen days beginning with the date on which the auditor ceases to hold office.*

(3) *Where the statement is of circumstances which the auditor requests to be brought to the attention of the members or creditors of the company, the company shall within fourteen days of the deposit of the statement either -*

(a) *send a copy of it to every person who under article 180 is entitled to be sent copies of the annual accounts; or*
(b) *submit an application to the court for an order that there are grounds of sufficient gravity to warrant that the statement should not be circulated.*

(4) *Where the company submits an application to the court, the court shall notify the auditor of the application and shall hear both parties before making a decision on the company's application.*

(5) *Unless the auditor receives notice of such an application before the end of the period of twenty-one days beginning with the day on which he deposited the statement, he shall within a further seven days send a copy of the statement to the Registrar.*

(6) *If the court is satisfied that the auditor is using the statement to secure needless publicity for defamatory matter -*

(a) *it shall direct that copies of the statement need not be sent out; and*
(b) *it may further order the company's costs on the application to be paid in whole or in part by the auditor, notwithstanding that he is not a party to the application.*

and the company shall within fourteen days of the court's decision send to the persons mentioned in sub-article (3)(a) a statement setting out the effect of the order.

(7) *If the court is not so satisfied, the company shall within fourteen days of the court's decision -*

(a) *send copies of the statement to the persons mentioned in sub-article (3)(a); and*
(b) *notify the auditor of the court's decision,*

and the auditor shall within seven days of receiving such notice send a copy of the statement to the Registrar.

The auditor cannot simply resign and walk away, he has in terms of article 161 he must make a statement and if there is nothing wrong, he must make a statement confirming this. He either has to investigate and bring it out or if he resigns, he has to state either there is nothing wrong or if there is he has to raise the issue. Within a matter of weeks, the auditor resigned and made a statement. The way the law is stated he is not entitled to provide a copy; the statement came in the hands of the wrong doers, and he deposited at the registered office for the company. if the auditor thinks there is something which should be known (sub article 3). The way the law is worded there does not give you entire protection.

The protection of minority shareholders also extends to a liquidation scenario, as per article 289 which stipulates:

> **289.** (1) *The court may, on the application of any member, creditor, or contributory, remove a liquidator if it is satisfied that there exist sufficient grounds to warrant his removal and appoint another liquidator.*
>
> (2) *A vacancy resulting from the death or resignation of a liquidator appointed by the Court may, on the application of any member, creditor, or contributory, be filled by the Court.*
>
> (3) *The person who applied to the Court in terms of sub-article (2) shall, in the case of a vacancy resulting from the death of a liquidator, inform the Registrar of the demise of the liquidator.*

Article 296(3) allows a member to apply to the court for directions as to the summoning and holding of meetings, stating:

> (3) *Where there is no continuing liquidator, any member, creditor, or contributory may apply to the court for directions as to the summoning and holding of a meeting.*

Article 330(3) on the requirements for conversion of commercial partnerships, states:

> (3) *Where the commercial partnership to be converted is a company, whether public or private, the conversion may only be made if it has been approved by an extraordinary resolution taken at a general meeting of the company. The company shall be required, for the purpose of the conversion, to redeem the shares held by the dissenting members, if they so request, on such terms as may be agreed or as the court, on a demand of either the company or the dissenting members, thinks fit to order.*

There is this protection to the minority shareholder at this stage because when you are in a company, your liability is converted into a share capital. Therefore, one may not want unlimited liability. As such, the law gives you protection to ensure that if you are not in agreement with the conversion then you are not assumed to be unlimitedly liable.

A similar protection is that under article 362(2), which states:

> (2) *Where shares in the recipient companies are allocated to the shareholders of the company to be divided otherwise than in proportion to their rights in the capital of that company, the dissenting members of that company may exercise the right to have their shares redeemed. In such case, the shares shall be redeemed on such terms as may be agreed or as the court, on a demand made either by any of the recipient companies or by any of the dissenting members of the company to be divided, thinks fit to order.*

Besides all of the above articles, there remain two articles always worth bearing in mind: 214 and 402, on the causes of dissolution and consequential winding up, and the protection of shareholders against unfair prejudice, respectively.

History of the Protection of Minority Shareholders

Constant conflict with the right of the majority to run the majority and the right of the minority shareholders to have their interests protected. You cannot run a company unless there is full respect to the majority rule. The notion of majority rule was established in our law in the case of ***Falla vs Sorrosis*** (12/03/1976) stated that the minority has to respect the wish of the majority. There are flaws in this rule, as what happens when there is abuse of this situation (do not act in the best interest of the company/minority being defrauded), have to look at the way the protection of minority shareholders has evolved. UK position Foss vs Harbottle, if a wrong is done to the company, it is the company itself which would decide whether it should take action to protect its rights and whether the company will take action or not depends on the majority decision within the company. the first limb of this case is based on the principle of separate legal personality and the second limb is based on the notion of majority rule. Since the majority might be the wrongdoers, over the years exceptions to the rule in this case have evolved. UK law has established 4 exceptions to this rule:

1. Where the transaction is ultra vires or illegal, the majority in a general meeting cannot authorise a company to act in a way which is ultra vires or illegal.
2. Where the transaction requires the sanction of a special majority, you have drafted you articles in such a way that you require certain threshold. A simple majority can never perform that particular transaction. ***Edwards v Han 1950***, Quinn Axtens ltd v …1901.
3. Where the transaction infringes upon the personal rights of shareholders which may arise from the articles of association, from law, or from separate shareholders agreement. Originally in the past the courts used to interpret the articles of association restrictively as to what constitutes a personal right. The

breach of the articles was not deemed to constitute a breach of personal right. The situation has evolved and now the situation is that same for clauses regarding internal procedures, all breaches of other articles are considered to be a breach of a personal right. This has also evolved even further so that a breach of a director's fiduciary duty gives shareholders a personal cause of action. English case: company no 5136 of 1986 decided in 1987 BCLC 82.

4. If there is fraud on the minority, most clear exception to the rule. The action that used to be brought is a derivate action. 2 elements must be sustained: fraud on the minority and secondly the minority shareholder must establish wrong doer control which prevents the company itself from bringing the action.

Vide the judgement in the case of ***Debattista v. Debattista*** which discussed the derivative action and fraud on the minority.

We have considered the idea of the majority rule and the case of Foss v. Harbottle and the two limbs thereof: if a wrong is done to the company it is the company itself which will decide whether to take action itself; and the decision is to be taken by the majority of the company. we have commented how this rule is hardly ideal if one is a minority shareholder. We have considered how over time UK judgements began establishing inroads into this rule and we have seen that there are four areas where inroads have been created: if an action is ultra vires or illegal; where a particular action requires a special majority and that requirement has not been respected; where a particular action infringes the personal rights of a shareholder and therefore there is a right of action for the shareholder; and, most important, the courts have dealt that when there is fraud on the minority, then the rule does not apply. This is the clearest exception to the rule as the others rely on other rules on company law. the first three inroads by and large are not really inroads, but an application of other rules within the regime of company law. the real exception to the rule is when we have a fraud on the minority.

Today, there are specific statutory exceptions to this rule, but it is important to be aware of these judicial inroads as they could still be applicable.

Fraud on the Minority

When we have fraud on the minority the action that used to be brought is a derivative action, brought by the shareholder who has been wronged for and on behalf of the company. In order to propose this action two criteria must be satisfied: first, that there actually is fraud on the minority; second, that he must prove that the wrongdoers are actually in control of the company and the way they are exercising their control is such that they are preventing the company from bringing an action itself to protect its own interests. Take, for example, a 30% shareholder in a two-shareholder company. The company decides to lease a shop owned by the company to the nephew of the majority shareholder at a rate far below the market rate. Both the minority shareholder and the company itself as prejudiced by this action. Since the majority shareholder is as such, he would not take action against himself for taking such a decision and the minority shareholder does not have sufficient strength to force a resolution to terminate the agreement. That is why in such cases the minority shareholder would have resorted to a derivative action.

Fraud on the minority is interpreted rather widely and also includes abuse or misuse of power and even self-serving negligence is considered to amount to fraud. *Vide* the cases of ***Daniels v. Daniels*** (1978) and ***Coke v. Deaks*** (1916). In so far of wrongdoer control consider ***Prudential Assurance Co. Ltd. v. Newman Industries Ltd.*** (1980) and ***Smith v. Croft II*** (1988).

A derivative action is an exception to the rule that one brings an action in one's own name as the company itself has not given one a power of attorney to being an action on its behalf. One is allowed to bring such an action because the Courts over time have allowed this to happen. For one to be a shareholder and to propose a derivative action one must be a clean person, that is not tainted with any wrongdoing oneself. If one is partaking in something illegal one cannot use the courts for protection (*vide* the case of ***Spiteri v. Cilia*** (2013)). Another element regarding this action is that there must not be any particular delay for one to propose the action, so one must convince the court that one has acted instantaneously and if one has not done so the delay must be justified. Third, one must keep in mind that when one is a minority shareholder proposing a derivative action one is acting on behalf of the company, meaning any winnings go to the company itself. *Vide* the cases of ***Towers v. African Co.*** (1904) and ***Nercomm v. Nercomm*** (1985).

For a while, we did adopt the derivative action in Malta, and it was proposed in the case ***Mixkuka Ltd. v. Mangion*** (Court of Appeal, 13/07/2020). One must keep in mind that one cannot propose a derivative action when the company is in liquidation as there is no concept of wrongdoer control in such a case as the company is controlled by the liquidator, not the majority shareholders. We have seen the English as far as *Foss v. Harbottle.* Originally, the Maltese courts embraces the judgement fully, and in the 1970s if one was the minority shareholder in a company one had no rights to speak of. There was an attempt to bring an action in *Falla v. Sorotos* (1976) to protect minority shareholders. This case applied *Foss* fully. Between 1976 and 1995 (when Parliament enacted the new Companies Act under which we have ad hoc remedies for minority shareholders under Articles 402 and 214) the Courts had already started creating some exceptions to the rule of *Foss*, even in Malta in the cases of ***Cecil Pace v. Emmanuel Bonello*** (Court of Appeal, 1996), ***Martin Bonello Co. v. Kenneth Co.***, and ***Edwin Zammit Tabone v. Emmanuel Grech.***

By and large the Maltese inroads into *Foss* can be divided into three categories: first, fraud on the minority; second, if there is an infringement of personal rights; third, a general category of cases where a remedy is necessary in the interests of justice. Regarding fraud on the minority *vide* the aforementioned cases of Zammit Tabone, ***Edgar Cachia Bonnici noe v. Oliver Agius*** (Court of Appeal, 06/11/1991), and ***Meatland Co. Ltd. v. Saviour Micallef*** (12/12/2001). In *Meatland* the court affirmed the possibility that a shareholder could use the derivative action, with the Court holding that a shareholder could exercise this action to protect his own interests under the company and to protect the rights of the company.

The second category of cases involves an infringement of personal rights. *Falla v. Sorotos* itself had mentioned that had there been such an infringement then he would have been able to bring an action. *Vide* the cases of ***Cornelius sive Morris Scifo***

Diamontino v. Eric Pace Bonello (Commercial Court, 29/11/1989) where the plaintiff was a shareholder who attacked a resolution passed in breach of the procedural requirements as contained in the articles of the company, and ***Dr Kevin Dingli v. Dr Joseph Bonnici*** (17/02/2003).

The last inroad is where one cannot really pigeonhole the case under the previous two, but the court still feels that in the interests of justice it shall allow the case to proceed, as was the case in ***Cecil Pace v. Emmanuel Bonello*** (Court of Appeal, 1986).

In 1995 we enacted the Companies Act and with this we got two remedies, one stronger than the other, that can be utilised by a minority shareholder: Article 214 and Article 402. The former is known as the just and equitable remedy whilst the latter is known as the unfair prejudice remedy. Article 214, per se, was not created specifically for minority shareholders, but it can be utilised by them, as it is that article where one is asking the Court to wind up a company entirely. Article 214 caters for different scenarios where one can ask the court to liquidate the company, such as if a company is unable to pay its debts. This action is naturally normally bought by creditors to put enormous pressure on companies to pay its debts. Article 214(2)(b)(iii) states that:

Under English law one will find cases under this aspect if one searches for the just and equitable remedy, but Maltese courts and drafters have yet to embrace the concept of equity. Prior to us enacting the CA in 1995 we were regulated by the CPO 1962 which was a copy of the UK Companies Act of 1948 and contained a remedy similar to this as Article 150G, under which one could have asked the Courts to dissolve a company if there were grounds of sufficient gravity. Thus, the Maltese courts had this opportunity before 1995.

In ***Daniel Cremona v. Joseph Lanfranco*** (CC, 09/09/1975) the Commercial Court held that this remedy which we now have in Article 214, was similar to Article 222(f) of the UK Companies Act 1948 and the Court held that since the source of the law was English, then it was justified to follow English judgements on the subject. That is why we rely on English judgements on the interpretation of our clauses.

The UK Judgement on this was ***Ebrahimi v. Westbourne Galleries*** where the House of Lords held that apart from respecting the formality and the letter of the law, one has to respect the underlying agreement between the parties, and this is what the just and equitable remedy is all about. If the Court feels that an injustice has been committed, even though the letter of the law has been respected, then the Court will provide a remedy. Therefore, the Courts are permitted to subject the exercise of legal rights to equitable considerations. Since then, *Ebrahimi* has probably featured in all judgements regarding the protection of minority shareholders.

English authors have created categories where the remedy of dissolution will be given in terms of this just and equitable remedy: where we have the concept of a quasi-partnership. A quasi-partnership is when we have a company that has begun on a small scale with an understanding between the shareholders that they would all be involved in the management of the company. Then, although one shareholder may

acquire more shares than another, if the original underlying agreement was that all the shareholders would be involved in the running of the company, then although the majority may pass a resolution to remove one of the shareholders from the management, the concept of having this “quasi-partnership” should prevail. This will be found in a number of cases involving small family companies with such understandings. The English case where this was established was ***re Yenidje Tobacco Co. Ltd.*** (1916) and, in Malta, ***Gatt v. Gatt***.

The second category is justifiable loss of confidence in the management, i.e., a lack of probity on the part of the directors. the English case is Lock v. John Blackwood Ltd. and Camilleri v. Frederick Frendo (04/07/2003).

The third category is the loss of substratum, meaning it is no longer for the company to achieve the purposes for which it was set up. In Camilleri v. Frendo the company had been established to operate a vessel which was sold. Another case is ***Christian Mifsud v. F1 Autotest Ltd.*** (29/11/2012).

Another category is a deadlock situation, the most common one. *Vide* the English case ***American Pioneer Leather Co.*** (1918) and ***Emmanuel Bezzina v. Walter Bezzina*** (01/10/1986).

Another relationship is the collapse of relationship between the parties where it is no longer tenable for them to remain partners. This has happened in Dr. Henri Mizzi v. Robert Dankjaer Malta Ltd. (01/11/2012), where the Court quoted the case of ***re Yenidje Tobacco Co. Ltd.*** and held that *“refusal to meet on matters of business … gustifikata”.*

The law does not define grounds of sufficient gravity but instead leaves it to the discretion of the Court to decide, basing its decision on all the circumstances of the case. If the court gets a feeling that there is an unfairness, it will dissolve. In this remedy, only dissolution exists as a conclusion. Normally, when one files a court case, it is like taking a snapshot of how things are at the moment of the case, meaning things that have taken place after the case was filed cannot be brought as evidence. There is an exception to the rule as when one files an action under 214, things that are happening as the case proceeds can also be brought as evidence, as was the case in ***Emmanuel Bezzina v. Walter Bezzina.*** Very often when we have issues of shareholders things do take place during the Court case. Furthermore, *vide* the case of George Borg v. Primrose and ***Boureghda v. Loureiro Et.***

When one files an action under 214 one is also entitled to ask for the appointment of a provisional administrator to manage the company as the case proceeds. Very often, this happens in cases where a creditor is bringing an action and thinks that the assets of the company will be depleted by the current directors, but it can also be utilised by minority shareholders. There is only article 228 which regulates the position of the provisional administrator. Lacunae have been closed by the judge who lays down the powers of the provisional administrator.

Before one applies for a dissolution under article 214, must one first exhaust all other remedies? This was dealt with in Camilleri v. Frendo where the Court held that it was not a sine qua non that one first exhausts all other remedies, but one must nevertheless be careful, as the Court will not dissolve the company if it thinks other remedies are available.

Article 402

The best protection a minority shareholder could possibly get is under article 402, that provision there specifically to protect them. An action in terms of article 402 can be brought by "any member of a company …". Under normal circumstances a member is a shareholder, but in sub-article (6) the legislator has chosen to widen this definition so that the term member is not simply someone whose name is registered in the memorandum of the company. A member can even complain about behaviour that occurred prior to him becoming a member, say if one became a shareholder and discovered that the directors were previously committing wrongdoings. Article 402(2) gives the right of action to the Registrar of Companies; however, this is immensely rare.

The shareholder need not be in the minority to bring an action in terms of Article 402, and there has been a case (Testaferrata Moroni Viani v. Testaferrata Moroni Viani Holdings Ltd.) where the majority has brought a case against the minority who was refusing to attend meetings of the company meaning there was no quorum, preventing the company from doing business. Before 1995 the single-member company was impossible, so very often if one wanted to start a company one would have to go to another and give them one share to satisfy the requirement. An issue arose as to whether a shareholder who only owns one share can bring an action, and they can. The issue arose as well as to the position of the spouse of a shareholder.

In ***Jean Carl Soler v. Vassallo Vibro Blocks Ltd.*** and ***Daniela Galea Souchet v. Cleland & Souchet Ltd.*** it was held that if the shares form part of the community of acquests between the spouses, then either spouse can bring an action even though the name of that spouse does not appear on the memorandum of the company. If, on the other hand, the shares are paraphernal to one spouse, the other cannot bring an action under article 402.

Article 402 caters for two scenarios: first, if the affairs of the company have been or are being or are likely to be conducted in a manner that is oppressive, unfairly discriminatory against or unfairly prejudicial to a member or members, or in a manner contrary to the interests of the members as a whole; second, if any act or omission of the company has been or are or are likely to be oppressive, unfairly discriminatory against, or unfairly prejudicial to a member or members, or in a manner contrary to the interests of the members as a whole. The key words are oppressive, unfairly discriminatory, and unfairly prejudicial. We do not have a definition of either term in the law, but these are used practically all over the Commonwealth where we find Common Law applications. Since we do not have a definition, each case must be seen on its own merits, as established in ***Michael Cutajar pro et noe v. SC & Co. Ltd.*** (FH CC, 30/01/2008). It is not the case that the petitioner must prove that he himself is suffering a prejudice. A petitioner can also bring an action if it is shown that another

member may suffer a prejudice or that the company as a whole will suffer a prejudice. In George Borg v. Primrose (06/01/2012) where it was stated:

"Ikun sodisfatta … tal-kumpanija"

In ***Vella et v. Vella Bros. Ltd.*** the Court of Appeal held as follows:

> *"L-Artikolu 402 ta' l-Att dwar il-kumpanniji jaghti diskrezzjoni pjuttost wiesa' lill- Qrati u dan ghaliex dawn il-provvedimenti ghandhom l-ghan li jissalvagwardjaw u jipprotegu lill-azzjonisti ta' socjeta` kummercjali, partikolarment lil dawk li huma minoritarji u li ghalhekk qeghdin fl-impossibilita` li jirregolaw il-mod li bih tkun qed titmexxa s-socjeta` li fiha huma jkollhom interess. Kif sewwa jissottomettu, l-argumentazzjoni ta' l-appellanti ma ssibx konfort la fil- kliem anqas fl-ispirtu tal-ligi li ma poggiet ebda limiti fuq is- sitwazzjonijiet li jaqghu fil-parametri ta' l-Artikolu 402 ta' l-Att, u fuq it-talbiet u r-rimedji li jistghu jinghataw, u dan ghaliex din id-disposizzjoni, li hija bbazata fuq l-Art. 459 tal-Companies Act (1985) Ingliza, hija ispirata fuq principji ta' ekwita` aktar milli minn drittijiet strettament legalistici biex ikun jista' jigi moghti rimedju. Dak li hu necessarju hu li l-azzjonista jipprova li minhabba l-gestjoni tas-socjeta` partikolari hu qed isofri, jew ukoll jista' jsofri, pregudizzju ta' natura oppressiva, ingusta jew diskriminatorja. Tali gestjoni tista' tirreferi semplicement ghal xi att specifiku jew xi ommissjoni tal-kumpannija. Il-pregudizzju jista' jirreferi ghall-azzjonist li qed jippromwovi l-proceduri, ghal xi azzjonist iehor jew ghall-interess in generali ta' l- azzjonisti. Ma hemmx ghalfejn li huwa jipprova li huwa zgur ser isofri xi pregudizzju fil-futur. Tali prova tista' ssir fuq bazi ragjonevoli ta' possibilita` (**Vincent Monreal et v. Lino Delia noe**, deciza mill-Prim Awla tal-Qorti Civili fit-13 ta' Mejju, 1999). In fatti gie deciz mill-Qrati Inglizi fil- kawza fl-ismijiet Re Bovey Hotel Ventures Ltd.11 li "the Court will not give a list of situations when this remedy may be resorted to however one principle remains clear. A shareholder may make use of this article when his shareholding in the company has been seriously diminished at least seriously jeopardized by reason of a course of conduct or the part of those who have the de facto control of the company, which has been unfair to the member concerned".*
>
> *Fid-decizjoni O'Neill v Phillips moghtija mill-House of Lords fl-20 ta' Mejju 1999, gie ritenut illi l-legislatur ried illi biex jinghata rimedju taht l-artikolu jigi kkunsidrat il- kriterju ta' dak li huwa 'fair'. Izda Lord Hoffman izid ighid li "Although*

> *fairness is a notion which can be applied to all kinds of activities, its content will depend upon the context in which it is being used".*
>
> *Fl-istess decizjoni inoltre intqal li –*
> *"The requirement that prejudice must be suffered as a member should not be too narrowly or technically construed".*
>
> *Il-pregudizzju jista' jirreferi ghall-azzjonist li qed jippromwovi l-proceduri, ghal xi azzjonist iehor jew ghall-interess in generali ta' l- azzjonisti. Ma hemmx ghalfejn li huwa jipprova li huwa zgur ser isofri xi pregudizzju fil-futur.*

Vide re Carrington Vella Plc, re Nobel & Sons, re London School of Electronics (1986), re Kumala Ltd. (1986), re Precision Bellows Ltd. (1984), re Co. No. 2614.

In ***Ellul v. Ellul*** a husband and wife had shares in a company before the situation between them deteriorated. The husband passed a resolution under article 140 to remove her as a director. The First Hall decided in favour of the husband, basing itself on his right to remove her under the Companies Act. Ellul appealed, basing her action on Ebrahimi. The Court of Appeals stated that:

> Fil-Ligi Ingliza (ara Art 459 tal-Companies Act, 1985) jinstab rimedju simili li hu maghruf bhala "The Unfair Prejudice Remedy". Il-Qorti ta' l-Appell Ingliza stabbilit fil-kaz "in Re Saul D. Harrison & Sons plc ([1995]) 1BCLC 14)" il-linji ta' gwida dwar kif kellu jkun l-operat biex ikun jista' jigi kkwalifikat bhala, "unfairly prejudicial" (fit-test tal-Ligi Maltija din il-frazi hi tradotta "b'mod mhux gust ta' pregudizzju"). Wiehed kellu, fl-ewwel lok, jara jekk dak l-operat kienx jew le skond l-istatut tal-kumpannija. Izda fl-applikazzjoni tal-imsemmija dispozizzjoni – ispirata fuq principji ta' ekwita` aktar milli minn drittijiet strettament legali – il-Qorti tiehu in konsiderazzjoni l-aspettativi legittimi ("legitimate expectations") li r-rikorrent jista' jkollu u li sikwiet ikunu ferm aktar wiesgha mid-drittijiet strettament legali li johorgu mill-istatut tas-socjeta`. Dawn l-aspettativi legittimi jitwieldu minn xi relazzjonijiet personali partikolari bejn l-azzjonisti. Fil-kaz Ebrahimi vs Westbourne Galleries Ltd. ([1973] AC 360) Lord Wilberforce elenka numru ta' sitwazzjoijiet fejn dan ir- rimedju jista' jinghata (ara ibid proprio 379), sitwazzjonijiet dawn li x'aktarx jinstabu f' kumpaniji zghar privati li ta' sikwiet jissejjhu "quasi partnerships", fosthom is- segwenti: -
>
> (i) an association formed or continued on the basis of a personal relationship, involving mutual

confidence – this element will often be found where a pre-existing partnership has been converted into a limited company.

(ii) an agreement, or understanding, that all, or some (for there may be "sleeping members") of the shareholders shall participate in the conduct of the business.

(iii) restriction upon the transfer of the members' interest in the company – so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere".

Not all companies are a quasi-partnership and the fact that one is a shareholder does not mean that one automatically has the right to be on the board. In the case of ***41 Ltd v. Full Finance Ltd.*** (21/12/2012), a shareholder was removed from being a director and brought an action in terms of article 402. The Court held that:

"In-nuqqas ta' …

Cases under article 402 can also be pigeonholed: first, quasi-partnership and removal from management; second, if the majority is paying themselves exclusive financial benefits. If a company never declares a dividend as the majority are employed in the company and keep paying themselves high salaries, a minority shareholder can bring an action under article 402. *Vide* the case or re Kumana Ltd. Another pigeonhole is where the majority shareholders are dealing with associated persons (*vide* Raymond Abdilla v. Gaetano Abdilla (21/01/1995) and Joseph Calleja v. Viktor Calleja). Another pigeonhole is where there is mismanagement of the company's affairs (E-link Data Ltd. (1991), George Borg v. Primrose). When one brings an action in terms of article 402 the law provides a series of remedies. One can either pick one's preferred remedy or leave it to the Court to decide which may be dangerous as if the Court decides it can force a majority to buy one's minority shareholding, at which point one must pay 35% in tax. Ideally, one chooses their preferred remedy to avoid this.

(3) If on an application made in terms of sub-article (1) or (2), the court is of the opinion that the complaint is well-founded and that it is just and equitable to do so, the court may make such order under such terms as it thinks fit -

(a) regulating the conduct of the company's affairs in the future [*vide Bank of America v. Iworld Group*]; or
(b) restricting or forbidding the carrying out of any proposed act; or
(c) requiring the company to do an act which the applicant has complained it has omitted to do; or
(d) providing for the purchase of the shares of any members of the company by other members of the company or by the company itself and, in the case of a purchase by the company, for the reduction

accordingly of the company's issued share capital; or

(e) directing the company to institute, defend, continue, or discontinue court proceedings, or authorising a member or members of the company to institute, defend, continue, or discontinue court proceedings in the name and on behalf of the company; or

(f) providing for the payment of compensation by such person as may have been found by the court responsible for loss or damage suffered as a result of the act or omission complained of, to the person suffering the said loss or damage; or

(g) dissolving the company and providing for its consequential winding up [*George Borg v. Primrose*].

One can also petition the Court for the appointment of a provisional administrator. One does not have this remedy under Article 402, as decided in ***Apap Bologna v. Bianchi*** and ***Ansillotti v. Glindi***. Instead, plaintiffs began petitioning the Courts to appoint a director to the Board to oversee as was the case in Pefaco where the Court appointed a director to conduct affairs. When one files an article 402 the procedure used is a *semplici rikors*, as held in ***Bridget Giusti v. Godwin Giusti***. Thus, there cannot be a counterclaim. As a result, there is no right of appeal from an action under Article 402. *Vide* Shaw v. Shaw and Antonia Baldacchino v. Balda Enterprises (19/01/2010).

One will find that there are some Court of Appeal judgements under Article 402, and this is because the lawyer representing the appellate party would not have raised the issue before the Court of Appeal.

Cases are becoming increasingly complicated which was not the intention of the legislator. In the UK they have amended the civil procedure rules to expedite this process and narrow down the evidence that can be introduced. Furthermore, whilst the case is ongoing the company is very often in trauma and in a suspended state which can harm it.

Second-Tier Shareholders

If one has shares in company A, a holding company, and the operations are being held by the subsidiary companies, and as such the wrongdoing is taking place where one is not directly a shareholder, can one bring an action? In ***Gordon Mizzi v. Dr. John C. Grech*** it was held that one cannot bring an action. However, in ***Jean Carl Soler v. Raymond Vassallo*** (COA, 03/02/2012) both parties were members of a holding company which had a subsidiary company where the alleged wrongdoing was taking place. The issue once again arose. The FH CC decided that a second-tier shareholder cannot, but the Court of Appeal held that:

"Ghalkemm artikolu …

In ***Suzanne Busuttil v. Francis Busuttil*** (06/05/2013) we returned to the same situation where one must actually be a shareholder in the company in which one is complaining.

Does the derivative action still exist?

Article 402(3)(e) contains the remedy to ask the Court to *"authorise a member or members of the company to institute, defend, continue or discontinue court proceedings in the name and on behalf of the company"* or to *"direct the company to institute, defend, continue or discontinue court proceedings".* One will appreciate the similarity between this provision and the derivative action. It has been debated whether it still exists once there is this remedy and whether one can use it today. *Vide* the case of ***Debattista v. Debattista*** (11/03/2023). The answer, so far, is that the derivative action cannot be used. *Vide* the case of ***Soler v. Vassallo*** (03/02/2012) where it was held:

"Li l-qorti taqbel … Maltija"

It was also decided in this in *George Borg v. Primrose*, where it was held that:

"… Verzjoni …"

if one is asked what actions were available to the shareholder before the enactment of the Companies Act, English case-law was relied upon wherein one found the derivative action. To exercise the derivative action the point of departure was Foss v. Harbottle (1843) which makes it clear that if a wrong is done to the company it is the company itself that must decide whether it will take action to protect its interests. The second limb of this case is whether the company will decide to take action or not is a decision taken by the majority shareholders within the company. one will appreciate that the first rule brings out the notion of separate legal personality whilst the second brings out the rule regarding the law of majorities. The biggest issue with *Foss v. Harbottle* is that if it is the majority in control and they decide not to take action which they will obviously do.

Therefore, the English courts created the notion of the derivative action whereby a minority shareholders could, if there were two particular elements, take action for and on behalf of the company. These elements where: first, wrongdoer control; second, fraud on the minority. In those cases where these two elements subsist the courts have allowed a minority shareholder who is not vested with legal representation of the company to still bring an action to protect the interests of the company. The action is brought for and on behalf of the company and any proceeds won by the action belong to the company. the person who brought the action is simply doing so to protect the interests of the company in the absence of action from those who *should* be protecting them. if a minority shareholder is tainted too, however, he cannot take action. Furthermore, one cannot propose a derivative action for a wrongdoing committed in the distance past.

Until the enactment of the Companies Act in 1995 this was a remedy which was available both in England and Malta. In point of fact the real test came in the case

Mixkuka v. Mangion (2000), the first decision, confirmed by the Court of Appeal, where a derivative action was proposed and allowed. Today, with the benefit of hindsight, it can be seen that this judgement was wrongly decided, as the derivative action cannot be exercised when a company is in liquidation as the wrongdoer is no longer in control, but the liquidator is.

With the enactment of the Companies Act, in Article 402(3) one finds a series of remedies that are available if one manages to prove that prejudice is being caused either to the minority shareholder or the company itself or to another member. Article 402(3)(e) is where the remedy given by the court is to authorise a member to either institute or defend a court action for and on behalf of a company. The issue arose, therefore, in view of the fact that the Companies Act itself has given an *ad hoc* remedy for a shareholder to bring an action for and on behalf of the company, and therefore it will attain the same effect as the derivative action used to attain, is there still the derivative action sitting alongside this specific remedy? The judgements which we have had so far by Mr. Justice Zammit McKeon reply to this question in the negative, making it very clear in Borg v. Primrose and Ray Vassallo v. Trigona that the Maltese remedy of the derivative action has now been replaced by Article 402(3)(e) and therefore Mr. Justice Zammit McKeon was not allowing the derivative action anymore. There is one dissenting judgement by Ms. Justice Anna Felice which allowed the derivative action, but it could be stated that as things stand the derivative action is no longer available in Malta in view of this provision. there have been cases where people brought an action under this Article, including that of *Mark Hogg v. San Tumas Shareholdings Ltd.*, where leave of court was sought by a shareholder to bring a case for and on behalf of a company. Those cases where Mr. Justice Zammit McKeon did not allow a derivative action where those where these actions were specifically requested.

At present, a heavyweight in juristic terms has ruled against derivative actions. Today, we wate to see whether Mr. Justice Spiteri Bailey will deviate from this thinking or not.

IX. The Auditor

The auditor is that person appointed to oversee the accounts of a company with one particular role: when one has an investment in a company as a shareholder but is not necessarily a director, one's only right of knowing what is going on within the company arises once a year at the AGM, whereat one is presented with the company's financial statements which would allow one to see how the company has fared in the previous twelve months. One is therefore trusting what is being presented by the company's directors. Therefore, the role of the auditor was created to certify that the contents of those financial statements are giving a true and fair view, and that therefore one finds an independent confirmation as to the veracity of the contents of those financial statements.

The definition clause of the auditor under the Companies Act refers to that definition of the Accountancy Profession Act, which, in turn, defines an auditor as "a holder of a practising certificate to practise in the field of auditing and includes an audit firm". Therefore, the auditor is the independent and competent third party who draws up the financial statements that are relied upon to give one a true and fair view of the position of the company. He is regulated by the Companies Act, by the Accountancy Profession Act, and by a myriad of other legislations.

As far as his appointment is concerned, Article 151(1) states:

> **151.** (1) *A company shall, at each general meeting at which the annual accounts are laid, appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of the next general meeting at which such accounts are laid. The company may appoint joint auditors and references in this Act to auditor or auditors shall be deemed to include references to single or joint auditors as the case may be.*

The first AGM can be held up to eighteen months after incorporation, which therefore begs the question as to the appointment of the very first auditor as at this first meeting an audit must already have been done. Therefore, it is the directors who must appoint the very first auditors of the company. It is only thereafter that the auditors are appointed by the shareholders, one of the functions for which an AGM is convened. When it came to directors, at the AGM, unless they are removed, they are automatically reappointed for a further term. This is not the case with the auditor as there is no presumption where an auditor would be reappointed and there must be an active decision in the form of a resolution to that effect. If no such resolution is taken, the auditor ceases to hold office.

It is possible also to have joint auditors, although this rare. However, if there is distrust between two factions in a company such that they cannot agree on an independent auditor, two or more auditors can be appointed independently for a joint audit. If no auditor is appointed, and one comes across this position very often, there is a residual right in terms of Article 151(4) given to any shareholder or to the directors or to the Registrar in Companies to file an application in court such that the court itself will

appoint the auditor. If it so happens that between one general meeting and another the office of the auditor is vacant, there is a residual right given to directors to fill in the casual vacancy.

With respect to the removal of the auditors, Article 157(1) states:

> **157.** (1) *Notwithstanding anything in a company's memorandum or articles or in any other agreement, the company may at any time remove an auditor from office in the same manner as that specified in article 140(1):*
>
> *Provided that an auditor may only be removed from office as aforesaid if there is a proper ground for dismissal:*
>
> *Provided further that divergence of opinions on accounting treatments or audit procedures shall not constitute a proper ground for dismissal.*

However, this is not exactly an echo of Article 140(1) as the proviso stipulates that an auditor may only be removed from office if there is a proper ground for dismissal, such that a simple majority cannot remove an auditor in the absence of a strong case. If the directors are not agreeing with the way in which the auditor is carrying out his work, they cannot use this reason to remove him. Article 157(2) stipulates:

> (a) *Where a resolution removing an auditor is passed at a general meeting of a company, the company shall within fourteen days give notice thereof to the Registrar for registration. The company shall also, within the same period, deliver to the Board a statement by the company giving an adequate explanation of the reasons for the removal of the auditor. If a company fails to give the aforesaid notice to the Registrar or the aforesaid statement to the Board, every officer of the company who is in default shall be liable to a penalty in respect of each default, and for every day during which the default continues, to a further penalty.*
>
> (b) *For the purposes of this sub-article, the Board shall have the meaning assigned to it by the Accountancy Profession Act.*

On the resignation of auditors, Article 159 stipulates:

> **159.** (1) *Without prejudice to the notification obligations in terms of article 17 of the Accountancy Profession Act, an auditor of a company may resign his office by depositing a notice in writing to that effect at the company's registered*

> *office. The notice shall not be effective unless it is accompanied by the statement required by article 161.*
>
> (2) *An effective notice of resignation shall operate to bring the auditor's term of office to an end as of the date on which the notice is deposited or on such later date as may be specified in it.*
>
> (3) *The company shall within fourteen days of the deposit of a notice of resignation give notice thereof to the Registrar for registration. If default is made in complying with this sub-article, every officer of the company who is in default shall be liable to a penalty, and, for every day during which the default continues, to a further penalty.*

Article 161, in turn, stipulates:

> **161.** (1) *Where an auditor ceases for any reason to hold office, he shall deposit at the company's registered office a statement of any circumstances connected with his ceasing to hold office which he considers should be brought to the attention of the members or creditors of the company or, if he considers that there are no such circumstances, a statement that there are none.*

This statement can hold great evidentiary value in cases of proving wrongdoing.

X. Co-Operative Societies

Regulated by the Co-operative Societies Act (Cap. 442 of the Laws of Malta), co-operative societies originally found popularity amongst the fishing and farming industries. A co-operative is in many ways similar to a company whilst retaining its own unique characteristics. Generally, it is easier to establish an LLC as opposed to a co-operative society. The Registrar of Companies and the Co-operatives Board both play central roles in the regulation of companies and co-operative societies respectively. The latter functions not only as a registrar, but also as a regulator, as one cannot operate and register a co-operative without the consent of the Co-operatives Board. Registration proceedings are far more cumbersome and typically take a number of weeks; a fact that generally dissuades potential applicants. Co-operatives are generally set up for mutual benefits and owners/members all have one vote; unlike in a company, whose shareholders vote proportionally to the number of shares they hold.

Governing Principles

The 2001 Co-operative Societies Act lays down seven binding principles that co-operative societies and the Co-operatives Board must adhere to, something with no counterpart for companies:

1. **First principle -** Voluntary and open membership: Co-operatives are voluntary organisations. open to all persons who are able to use their services and willing to accept their responsibilities of membership, without gender, social, racial, political, or religious discrimination.

2. **Second principle -** Democratic member control: Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and taking decisions. Men and women serving as elected representatives are accountable to the members. In primary co-operatives, members have equal voting rights - each member having one vote only. Co-operatives at other levels are also organised in a democratic manner.

3. **Third principle -** Member economic participation: Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, at least part of which would be indivisible; benefitting members in proportion to their transactions with the co-operative; and supporting other activities approved by the members.

4. **Fourth principle -** Autonomy and independence: Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including the Government, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5. **Fifth principle -** Education, training, and information: Co-operatives provide education and training for their members, elected representatives, managers, and employees so that they may contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of cooperation.

6. **Sixth principle -** Co-operation among co-operatives: Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional, and international structures.

7. **Seventh principle -** Concern for the community: Co-operatives work for the sustainable development of their communities through policies approved by their members.

Minimum Requirements

Currently, the minimum number of members in a co-operative is five, as opposed to 2 for a company (according to article 68 of the Companies Act). Unlike companies, co-operatives can be registered on a provisional basis. Whereas companies have a board of directors (and can have a minimum of one if set out in the memorandum), co-operatives have what is known as a 'Committee of Management'. A co-operative can opt to also have a supervisory board, although this is purely optional, with few of the roughly 60 co-operatives in Malta choosing to establish one. Only co-operative members can sit on the committee of management whose functions are to properly conduct the affairs of the co-operative.

Apex Organisation

The law stipulates that the majority of co-operatives must be grouped into what is known as an 'apex organisation', which acts as a trade union and lobby group. Co-operatives do not pay tax in Malta (according to article 12(1)(c)(iii)(C)(q) of the Income Tax Act), meaning some might be tempted to establish this type of organisation for tax purposes. However, they do pay 5% of their income to a Central Co-operative Fund which uses the capital for general purposes to benefit the co-operative movement. Co-operatives must also keep proper accounts and be audited like their company counterparts. The Co-operatives Board has the power to dissolve a co-operative whereas the courts alone can dissolve a company.

Co-Ops vs LLCs

Maltese law offers a varied selection of forms and vehicles for the carrying on of business and other activities. The most popular form is by far the private limited liability company. These notes highlight the special legislation and the peculiar features relating to co-operative societies. Inevitably one finds co-ops compared and contrasted to the private company, highlighting not only the different social objectives and roles they play in the community, but also differences in the internal structures and arrangements. In several ways, co-ops are similar to companies, but in many others, they are very different. The books and literature on companies are much more extensive, varied, and popular than materials about co-operative societies. For all

these reasons, company law has developed remedies and solutions not yet found in co-operative experience. It is not excluded that local courts may be willing - in the right circumstances - to extend to co-operatives the judicial remedies and corporate governance principles developed from experiences with companies. This should happen with great caution taking into account the different nature and objectives of the co-operative form.

The co-operative society is a vehicle for carrying out commercial or other activities. It is one of several organizational models specifically recognized by law whereby persons can join together to pursue a common objective. The setting up and the administration of co-operatives is subject to special legislation and overseen by a special public agency. The company is seen as a capitalist model with profit as its main objective, whereas co-operatives seek more enlightened social purposes. Co-operatives are a type of enterprise which has special features and internal arrangements, and which pursues its activities in a particular way. One often finds them described as a 'business with a special mission', whereas companies are deemed as classical capitalistic models run for profit.

However, one needs to read these terms with great care as co-ops are there to make a profit as otherwise, they would not survive. Co-operatives are much less common or popular than companies, with which they are often compared. Co-operatives and companies share some characteristics but then they differ in other essential ones. It is important to be able to distinguish a co-op from a company. There are about 70 co-ops which largely operate in the services, agricultural and fisheries sectors. In contrast one finds that about 90,000 companies have been registered. The current law is the Co-operative Societies Act 2001 which replaced the 1978 Act which carried the same name. The 1978 Act had replaced an earlier original law of 1946. Whereas the 1978 Act largely relied on the work of a leading German expert, the 2001 was a home-grown effort. The 2001 Act consists of one-hundred and eleven articles and three schedules at the end, updating and improving the 1978 law. Originally, the object was to amend the law rather than to replace it. However, the proposed changes became so extensive that a policy decision was adopted to replace the whole Act.

The Co-Operatives Board

Just as the Companies Act 1995 replaced the Commercial Partnerships Ordinance of 1962, the 2001 Act improved, modernised, and replaced the 1978 law on co-operatives. The 2001 Act introduced several new features and provisions and brought the level of regulation quite close to the level found in the Companies Act of 1995. The main objectives of the 2001 Act were to create a more modern and workable statutory framework for the setting up and operation of co-operative societies and for their registration and supervision and eventual closure and winding up, as well as to reduce certain discretionary powers of the Board and the minister. One finds a definition of a co-operative society in article 21 which also lists the principles that co-operatives are expected to comply with. These are seven international principles which set out standards for co-operatives generally. The 2001 Act retained the Co-operatives Board originally set up in the 1978 Act and listed its regulatory functions and powers. The functions are varied and extensive and include the registration, supervision, and

promotion of co-operatives, and also to assist and monitor them. The principal functions are listed in article 3.

The Board also serves as a registrar of co-operatives. The registry kept by the Board has to be accessible to the public, which means that anybody can inform himself regarding the statute and financial statements of a co-operative. This mirrors the situation with the Registry of Companies which obviously requires a much larger public records office. Coops follow particular financial rules. They have a special accounting model which uses the word 'surplus' rather than profit, and where states that a departing member does not benefit from the asset appreciation during his membership. The financial reporting rules are very similar to those applicable to companies but with some differences. While unlike companies, coops are exempt from income tax, they are obliged to place 5% of their surplus into a statutory fund called the Central Cooperative Fund to be used to assist coops in various ways in line with a recently changed regulation dedicated to it.

Registration

Co-ops need to be registered by the Board and provisional registration is allowed. Five members are the minimum allowed and there is no minimum share capital. The registration process is much more complex and time-consuming than for companies. The Board is obliged to establish that every new coop would be "viable" and has an adequate business plan and management structure (see article 29). Unlike companies, co-ops may be registered provisionally (article 28). The Registrar of Companies does not enjoy similar powers or responsibilities. To a degree therefore co-ops are more regulated than companies, especially at the preparatory and formation stages. The formation of a co-op tends to take much more time than that of a private limited liability company, and this is seen as a particularly significant disadvantage.

The First Schedule to the Act consists of an application form which every proposed new co-op would have to fill and complete. This application form requires the signatures of the prospective member and is intended to make sure that they have a clear idea of what they are going into and why. In fact, one of the items on the form requires *"detailed reasons for forming the society"* and the *"main purpose for which the society is to be organized"*. In this context, article 23 requires the *"founding members"* to address eight relevant matters before proceeding to apply to form a coop. These include undertaking a *"feasibility study"* into the proposed "economic and practical aspects" and the organisation of *"educational meetings to discuss the proposed society, its operations and its benefits to members".* Upon receiving an application, the Board may either decide to register it, reject the application, or register it provisionally.

These pre-formation responsibilities are peculiar to co-ops. In order to assist people wishing to set up a co-op, the law also adds a comprehensive list of matters that a co-op statute would need to include. This is found in the Second Schedule which makes reference to article 34. The Board has made available a standard model that can be used as the basis of the co-op statute. Any amendment to a co-op statute would need

to be first registered with the Board to be valid. The Board checks that the proposed changes are legal and consistent with the other provisions of the statute.

Committee of Management

Every co-op must appoint a committee of management which is similar or equivalent to the company board of directors. Co-ops may choose to have a second tier of management known as the Supervisory Board. Under the 1978 Act, the supervisory board was mandatory but in time proved to be a spectacular failure. The Act also provides for several other internal co-op financial and administrative matters. Every co-op must appoint an independent auditor. Similar rules as for companies apply. Where auditors find material irregularities, they are obliged to report them to the Board which has an over-arching role of supervising the auditing of co-ops. Auditors are also required to certify that the coop has functioned in accordance with the law. The 2001 Act introduced new rules on companies holding shares in co-ops; on co-ops setting up a subsidiary company; and on how members may or may not compete with their co-op. Internal disputes are now to be referred to decision by the Malta Arbitration Centre.

Dissolution and Winding-Up

A whole section of the 2001 Act consisting of four pages is dedicated to the dissolution and winding up of coops. A deliberate attempt was made to bring the winding-up rules for coops closer to the company law framework introduced in 1996. These provisions were a great improvement on the meagre and unsatisfactory provisions in the former law which basically assigned absolute powers to the Board to manage and oversee the liquidation process. Nevertheless, even in the new law the Board has retained significant powers of intervention.

Indeed, it is the Board alone which can issue a “dissolution order” and it may “on its own motion” decide to dissolve a coop if certain circumstances exist. Upon issuing such an order, the Board not only appoints a liquidator but is also explicitly made responsible to oversee the whole winding-up process (article 102). It is not the Co-op or its members who make the appointment. The liquidator is obliged to submit an annual progress report to the Board which may even dismiss and replace the liquidator. The situation is therefore markedly different from company law. Article 101 lists the duties and powers of the liquidator while various articles provide for how the dissolved cooperative’s funds are to be administered and paid out. Article 105 requires the Board to keep a Cooperative Societies Liquidation Fund where surplus or unclaimed amounts are to be deposited. In conclusion, the powers and duties of the Board are still considerable in the area of winding-up of co-ops, and they may merit to be re-considered and reduced. It is to be noted that the rules on winding-up rules in the Companies Act are much more complex and detailed (and even these were a watered-down version of UK Insolvency Act law enacted in 1986).

Conclusion

In several aspects therefore, co-ops are different from companies: co-ops are obliged to abide by seven fundamental principles whereas companies do not; a co-op may be registered provisionally; co-ops have the APEX organisation; co-ops have the Central

Co-operative Fund; the Co-operatives Board has more regulatory and intrusive powers than the Registrar of Companies; the Board has wider powers in the field of dissolution and winding up of co-ops; company registration is automatic and the Registrar has no choice in the matter; companies do not have the possibility of provisional registration; co-ops have members whereas companies have shareholders; unlike companies, co-ops can decide to set up a second-tier supervisory board; companies face no restrictions on having subsidiary companies; the defunct company concept finds no equivalence in the co-operatives law; the dissolution and winding-up rules are very different and company law does not have anything quite like the Liquidation Fund.

XI. The Overseas Company

Since at least the Companies Act of 1948, foreign companies operating an established place of business in the UK have been obliged to register their place of business with the Registrar of Companies in order to provide some safeguards and re-assurance to third parties in the UK dealing with these foreign companies. The concept was taken up in the Commercial Partnerships Ordinance and was eventually retained in the Companies Act. Today we find the rules governing this phenomenon of the 'overseas company' in Part XI of the Companies which is wholly dedicated to this matter. The relevant articles are 384 to 399. Overseas companies are peculiar because - as their designation implies – they are companies registered and formed outside Malta. They are foreign incorporated entities which have not incorporated a subsidiary or a new company here but may have set up a business office or other place of business or a branch. We shall here refer only to companies for the sake of simplification because the law also envisages other foreign bodies corporate 'whatever their type', apart from companies. They can include partnerships.

So, these are the two basic notions we have to bear in mind here:

(a) A foreign registered company or partnership,
(b) Which has established a place of business or branch in Malta.

Filing and Disclosure Obligations

Once it qualifies as such, the foreign company enters into a new and slightly more complex framework which requires it to register and to abide by significant filing and publicity obligations. Within one month from establishing its place of business, the foreign company is obliged to have it registered with the Registrar and file a copy of its statute in English or Maltese with a certified translation, if necessary, together with an explanation of its legal form and its foreign registration and registration number. It would also need to list its directors and secretary, if any, and the persons having the legal representation of the overseas company. In each case, the individual's name, nationality, and residential address has to be provided. The requirements, one will note, largely duplicate those expected from a normal company being registered in Malta.

Other specific publicity requirements relate to the name in which business is being carried out in Malta if different from the company name, the address of the place of business or the principal branch thereof and the activities carried out thereat. Another requirement of particular importance is the need to state the name of a local representative to represent the foreign company in legal and judicial matters relating to the branch in Malta and the extent of his authority.

Another important obligation faced by overseas companies is the requirement to file financial statements on an annual basis just like ordinary Maltese registered companies. The law raises some specific requirements and allows some alternatives in this regard because foreign corporate requirements differ, and the Registrar has an important compliance role in making sure that the type and extent of disclosures that the law requires are in fact respected. Any changes to this information would have to

be notified to the Registrar within one month on returns established for that purpose in the Act.

A Place of Business

The whole framework revolves around the establishment of a place of business. The two basic requirements would have to be assessed on a case-by-case basis:

1. An actual physical place, an office, a shop, a store a warehouse, a building site, a factory
2. Business, trade, commerce, or activity ancillary thereto is actually carried out there on a more or less regular and visible basis.

Unless there is an established, specified, and identifiable premises usually with a visible sign or physical indication, then these rules do not apply. A travelling salesman who appears on the island occasionally and who contacts clients and lodges for a few days in a hotel would not be caught by the Act which instead requires a degree of permanence and visibility, a concrete connection with the locality. A fleeting presence would not amount to an established place of business. Purely ancillary or administrative activities too might not amount to carrying on of business. The first overseas company registered in Malta involved the Hotel Phoenicia (OC no 1) which certainly qualified as a place of business. Rather than being set up as a Maltese company, the hotel was operated by a UK company which as a result had to register the hotel as a place of business with the Registrar.

XII. Why Companies Fail, Cont.

Unless there is a prescribed period in the company's memorandum, a company can enjoy its existence indefinitely. The Hudson Bay Co. was established in 1670 by Royal Charter. Known as charter companies, these enterprises were given monopolies over huge tracts of land. This particular company was given a monopoly on fur trading in most of what is today Canada and the northern United States. Similarly, there may be companies that live for short periods of time, like those swept away in the dot-com bubble. Alternatively, once highly successful companies can find themselves insolvent. In the past commercial partnerships were established for fixed terms. However, the issue was that these clauses were often forgotten, leading to one case where an ordinary company had established a ten-year period in its memorandum leading to the dissolution of the company if not extended. The company grew into a going concern and was successful until an auditor read the articles of association and noticed this clause. Strictly speaking, the company should have been wound up five years prior. The company continues to file audited accounts with the Registrar and holding AGMs, such that there was no interest in winding the company up. What the company did was quietly change its M&A, removing this clause with the fixed term, passing an extraordinary resolution, before filing it with the Registrar.

Case-study: US Regional Banking Crisis & Credit Suisse

Corporate governance failings: VW emissions scandal

Gala Appliances was a privately owned company, owned by the Borda family, which closed in May of 2023.

Nokia and Blackberry