CML2011 COMPANY LAW

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MALTA

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ELSA Malta President: Jack Vassallo Cesareo

ELSA Malta Secretary General: Beppe Micallef Moreno

Writer: Luca Camilleri

Introduction to Company Law

Prof Andrew Muscat
Dr Ilona Schembri
Dr Tiziana Filetti
Dr Kris Borg

Introduction

Maltese company law is by and large modelled on its English counterpart. The two organs of a company are the board of directors and shareholders. The function of the board of directors is to represent the company, often enjoying the legal and juridical representation thereof. Whilst the board is entrusted with the daily running of the company, shareholders enjoy certain residual rights. Take, for example, the fact that shareholders enjoy the right to appoint and remove directors. For the purposes of these lectures focus shall be placed on the limited liability company because as the result of this limited liability a number of important consequences emerge, namely, that the liability of the company is separate and distinct from that of its shareholders. The rights and liability of a shareholder is dependent on the number and class of the shares he holds. The liability of a shareholder is therefore limited to the part unpaid, if any, on his or her shares.

Besides liability, another consequence of separate judicial liability is that the assets of the company are separate and distinct from those of the shareholders. Another important consequence of separate juridical personality is the fact that a company can sue and be sued in its own name, independently of its founders. This element of continuity is extremely important and the transition of shares after death is a relatively simple process. These issues and more shall be considered throughout the year. Also, to be considered are specific issues, such as the process of incorporation of a company which requires what is often referred to as the corporate statute or the memorandum and articles of association. It is this document which governs the relationship between the shareholders and the company itself and between the company and third parties. This document is so instrumental that it filed at the company register and access is given to all. If one is entering into a transaction with a company, it is important that these records are made public for review. Furthermore, we shall also enter into the notion of share capital. The fact that their capital is divided into shares is a distinctive feature of the LLC. Shares decide everything including the voting rights of the company's shareholders. Another core aspect of the limited liability company is the lifting of the corporate veil, the exception to the general rule of separate juridical personality. Separate juridical personality might give rise to abuse as certain individuals might hide behind the veil of incorporation to avoid their obligations which is why the process of lifting the corporate veil was developed. That said, this is an exception to the general principle which is always that a company enjoys a separate juridical personality. In general, instances of lifting of the corporate veil are divided into two main categories: either statutory inroads (such as in the case of fraudulent or wrongful trading), or judicial inroads (such as in the case of an action of fraud).

Another doctrine to be considered is that of capital maintenance. We shall see that the law imposes set requirements when it comes to share capital, imposing a minimum and a maximum, and certain rules on the transfer of shares. The capital maintenance rules are there to ensure that the capital raised in order to incorporate the company is actually maintained. It is to be said, although this doctrine still exists, that a number of academics are against this doctrine because it does not truly safeguard the interests of shareholders, because whilst a share may have the nominal value of one euro, its market value may be 10,000 times that, or vice versa.

Another topic to be dealt with are company directors, specifically the types of directors recognised and the processes of approval and removal thereof. Eventually, we shall consider the duties imposed on directors and one will note the range and complexities of duties imposed by directors as regulated by the Companies Act and the Civil Code. Related to the idea of the duties of directors is what is referred to as the doctrine of *ultra vires* which, in this case, refers to two scenarios: either that the company itself has acted *ultra vires* its powers, or, alternatively, a director has acted *ultra vires* the specific powers given to him in terms of the memorandum and articles of association. The drafter must create a clause that is sufficiently broad that the company's actions rarely fall outside the scope of its *vires.* Another salient feature of the M&A is the legal and representation clause which typically states that any two directors can sign a contract on behalf of the contract.

Another important aspect of Maltese Company Law to be considered is the procedure for a company general meeting, specifically the procedure for an annual general meeting (AGM). Specifically, the law regulates, *inter alia,* quorums, the taking of minutes, and reports. Furthermore, we shall also consider the statutory protection of minority rights or shareholders.

Companies exist in multiple forms, such as the LLC as opposed to partnerships. The LLC is further divided into the SIVAC, the SME, the public company, etc. N.B. that a public company need not be one listed on the stock exchange.

Topic I: The Basic Notions of Company Law

If one had to stop and think about commercial transactions going on all the time and asked oneself who will be involved, the answer is invariably lawyers. Commercial transactions can be carried out by ordinary individuals who can be traders, by some form of commercial partnership, or by other types of entities such as a foundation, a government, etc. Generally, the majority transactions of a commercial nature are entered into by companies. Indeed, it can be said that some 99% of commercial transactions involve companies at least on one side. In other words, companies are pervasive throughout the corporate scene. Even something as simple as buying milk is a transaction involving a limited liability company. Companies then trade amongst themselves on an ongoing basis throughout the world. Clients may well be companies themselves but even if they are ordinary individuals the likelihood is that if a dispute arises the counterparty would be a company. It is therefore important for lawyers to be familiar with the principles of company law because they would be required to advise on issues that often have issues of company law involved. Take, for example, a lawyer who is asked to give advice on the transfer of shares in a company; or one who is asked to advise on a merger or an insolvency. Even in the civil sphere one would be well-served to know company law. Take, for example, a lawyer involved in the purchase of an apartment whose vendor is ready to enter into a promise of sale but discloses the fact that the property is to be sold by a company which has not yet been registered but is in the process of doing so. Can one sign on behalf of a company that has not yet been registered? This is the type of question company law seeks to answer.

How does one go about setting up a company? Is a company set up by the will of the parties involved? Does it involve just the drawing up of an agreement between them? Naturally, the answer to the latter two questions is no, as the MBR requires a signed M&A duly registered therein for the company to be properly formed and come into existence.

Alternatively, another issue is what is the juridical nature of a company? Companies are juridical persons in their own right making them a person for all intents and purposes. Another issue is the lifting of the corporate veil. The principle of corporate personality is that the company is separate from its shareholders such that its members are in principle not liable for what the company does. However, there may well be exceptions to this general principle and the study of these exceptions is grouped as the lifting of the corporate veil.

We shall also consider the notion of the board of directors and general meeting, i.e., the bundle of shareholders together. Issues to be considered are the interplay between shareholders and directors, and how do shareholders meet and how do directors meet, and what formalities are required with regard to these meetings to ensure that decisions are validly taken. To that end we shall consider the rules governing the notices of meetings, quorum requirements, etc. Can shareholders instead of actually meeting to take a decision pass a resolution in writing signed by all members or all directors? and would it be as valid as decisions taken in a meeting proper? Yes. Similarly, in company law, because there are a number of shareholders, disputes arise between them. Occasionally, disputes may arise between majority and minority shareholders.

Another area that we will be looking into is the financing of companies from a company law perspective, i.e., the notion of how capital is raised in a company.

Topic II.2: The Salient Features of Companies and Company Law

The salient features of companies and company law are as follows:

1. The basic structure of a company: Companies have two organs which are absolutely fundamental to their functioning, the shareholder/s (who own the company) and the board of directors (who run the company). There is no rule as to maximum or minimum amounts for shareholders, although there are exceptions to this. The board of directors can be composed of at least one person and again the general rule is that there is no maximum or minimum number of directors, although again there are exceptions to this rule.
2. A company can only come into existence if it is registered with the Malta Business Registry following the drawing up of the M&A.
3. As a rule, a company must have a minimum of two shareholders, although this is subject to exceptions.
4. A company must have share capital which must consist of a number of shares of a fixed nominal value.
5. A company is a separate juridical person.
6. The notion of limited liability: This is not for the company itself, but for shareholders.
7. Companies have very strict disclosure requirements, usually through the publication of their financial statements.
8. Company law has become increasingly complicated: Company law itself is primarily contained in the Companies Act but as soon as one starts speaking of special types of companies the complexity becomes even deeper. E.g., if a company is formed as a public company and is quoted on the stock exchange it will be regulated by an additional set of rules.
9. The transfer of the shares in a company is quite straightforward, making the transfer of a company relatively easy as opposed to the normal transfer of a business.
10. There are different stakeholders involved in a company, beyond simply the shareholders and directors: Companies involve other interested parties, such as the CEO, employees, creditors, regulatory agencies, the VAT Department, the Income Tax Department, etc.
11. There are different forms of companies: The basic forms are the private limited liability company and the public limited liability company. However even the former can be subdivided into the single member company and the non-single member company. By and large the rules on company law apply to whatever type of company and some nuances shall apply to the specific companies, and part of the exercise lawyers undertaken is to determine which rules apply to a particular company.

Directors and Members

The shareholder-director dynamic is an important feature of company law because the latter encourages and has always encouraged what is called centralised management. Until around that period of time whenever people who wanted to get together to invest in a business venture there could be any number of individuals. At the time when this practice was commonplace those same investors would want and expect to be actually involved in the running of the business. It was eventually realised that this was not particularly efficient and often led to dispute, so when the idea of company law was created to take on many investors, the idea developed to create a centralised management organ, thus the board of directors was born. The board is a group of people appointed by members but once they are appointed and a board is formed from then the business of the company is managed entirely by the board of directors, being a very efficient way of dealing with any business that the company needed to enact. The relative point to make is that when shareholders delegate the business of the company to be managed by a handful of directors who may not be shareholders themselves,

how do they ensure that the directors manage the business properly in the interests of shareholders. To that end, an important area of company law is that there is a set of rules which regulate the duties of directors. That is to say, they must exercise their powers according to law and they have a concomitant number of duties which they must observe when acting as directors. This would eventually lead to the topic of duties of directors.

Issues that arise in connection with this structure include the process of appointing directors, the length of tenure for directors, whether they can resign or be removed, whether they can change, etc.

The Company Formation Process

A company can only come into existence if it is registered in the Malta Business Registry and an M&A is drawn up and signed. As a rule, the registration of a company is a very simple process, however, there may be some situations where the registration of a company, especially if it is a license company, becomes more complicated. To begin with, the shareholders must agree upon and sign the Memorandum of Association and the Articles of Association. Very often when shareholders go to a lawyer or an accountant to form a company for them the lawyer would have a standard specimen M&A. The necessary changes will be made, and the document will be signed. The lawyer will also need to ensure that he has in place all the Know Your Client (KYC) and CVD documentation relating to the shareholders and the directors. Another important part is to make sure that the initial paid-up capital is deposited either in a bank account or with the lawyers setting up the company and evidence of this payment is available because that will also need to be presented to the MBR. There will also need to be the consent of the directors to act in writing and the payment of the registration fee to the MBR. Once these initial bits are well-organised the lawyer goes with these documents to the Malta Business Registry.

A desk officer will be assigned to examine the documentation and if he is satisfied within a day or two the company will be registered. These officers are trained to look into every aspect of the documentation and will have a detailed checklist and if anything is missing, they will send the documents back. This is the most straightforward scenario where a company is registered easily. There will be other scenarios which take more time, e.g., if the shareholders are not physically present in Malta and they therefore cannot sign the M&A physically, then one will either have to send the document by courier and get it circulated amongst the shareholders, or one will get powers of attorney to appear on behalf of those shareholders abroad. This is done quite regularly but a proper copy of the power of attorney is required. If then the company to be formed is a company licensed by, or will need to be licensed by, the MFSA, then the whole matter becomes significantly more complicated. Not so much in relation to the registration of the company per se, but because the MFSA will need to also look into the proposed activities and eventually issue the license that the company will need. Depending on the company involved the whole licensing process may take a number of months. One will not be able to register the company unless the MFSA offers a letter stating it will issue the license once the company is formed.

Topic III: The Notion of Share Capital

This idea of capital has a number of meanings. Any lawyer working in this area of law draws a distinction between share capital as opposed to loan capital. Our focus will be on the former and, put simply, share capital refers to funds that are contributed to the company's resources by the shareholders. One is obliged to pay this amount in order to enjoy one's position of shareholder *qua* shareholder. More importantly, a shareholder represents rights in the company. With regard to loan capital, this phrase is a commercial expression usually referring to the funds that are borrowed by a company other than by short- or medium-term borrowing.[1] Like any other sort of debt this debt may be secured, and the most typical form of security takes the form of a general or special hypothec. Another example of a loan capital is what we call debentures which give its holder a right of priority in the case of liquidation. Whilst a share represents a right with the company, loan capital represents a right against the company. In company law, share capital has various divisions, such as what is referred to as the authorised capital, i.e., the total of the nominal value of the shares which a company may issue. By law, this figure must appear in the capital clause of the company's M&A.

Article 69(1)(f) of the Companies Act refers to it as *"the amount of share capital with which the company proposes to be registered".* This is sometimes referred to as the nominal capital of the company. The implication is that if a company cannot issue shares in excess of its authorised capital if the company attempts to do so the issue will be unlawful and void. Issues relating to capital maintenance invariably come up. On the other hand, issued capital is the total value of the nominal value of the shares allotted to shareholders and it this part of the authorised capital that is actually taken up by the shareholders. This information must be included in the share capital clause. It goes without saying that the difference between the authorised and issued share capital represents the unissued share capital. Another term referred to is paid-up capital, i.e., the amount of issued capital, which is paid up by shareholders, which is calculated by multiplying the number of shares taken by the subscribers with the corresponding amount paid up in respect thereof.

Another important aspect to be aware of is the distinction that exists between the true value as distinct from the nominal value of a share as the true value of a share does not usually correspond to the nominal value of a share. Finally, one must be aware of the fact that certain thresholds are included in the Companies Act, such as a minimum authorised and issued share capital (*vide* articles 72(1)-(2) of the Companies Act). Note that different minimum capital requirements apply depending on whether the company is a private or public one. Linked to these minimum thresholds are minimum percentages that need to be paid up depending on whether a company is private or public, emanated from article 72(3) of the Companies Act. It is 20% in the case of a private company and 25% in the case of a public one.

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[1] "Share capital refers broadly to the funds contributed to the company's resources by the shareholders, *qua* shareholders. Share capital represents rights *in* the company. Unlike share capital, the term "loan capital" is not a legal term of art. It is a commercial expression usually referring to the funds borrowed by a company other than by short- and medium-term borrowing.

"The debt may be secured (for example by a general or special hypothec or by a mortgage) or unsecured. Loan capital sometimes takes the form of debentures. In contrast to share capital, loan capital represents rights against the company".

It is a fundamental principle of company law that a company must have a share capital divided into shares of a fixed nominal value.[2] Many companies are set up with an issued share capital of €1,200 divided into 1,200 shares of a nominal of €1 each. The original shareholders to the memorandum of association will take up these 1,200 shares. The term issued means that the shares have actually been made available by the company and are in the hands of the shareholders.

When shareholders agree on an arrangement, very often, the shareholders will pay for the shares that are issued to them in full so that the shares will become fully paid-up. In this case, when the company is being formed, each one of them is being issued 600 shares and must pay €1 for each share he has acquired. In that case the shares will therefore be 100% paid-up. The law also allows a lesser amount to be paid on the shares; indeed, there is a minimum amount that can be paid leaving the remaining balance to be paid at some future date, with this minimum amount being 20%, in the case of private companies and 25% in the case of public companies. If the shareholders wish to pay only 20% of the issued share capital, they can do so such that up front 20% of their 1200 shares are paid by A and B leaving the remaining 80% unpaid and to be paid for at a later date. There will come a time when the remaining 80% will need to be paid either at a stipulated time or in the case of a stipulated event. There is a rule that the minimum share capital in the case of a private company has to be the equivalent in euros of 500Lm, whilst in the case of a public company the minimum share capital has to be the equivalent of what was 20,000Lm in euros. The equivalent of 500Lm is almost €1,165 which is often rounded up to €1,200, whilst the equivalent of 20,000Lm is rounded up to €46,000.

The nominal value is, in this scenario €1 so the issued share capital is made up of 1,200 divided shares. However, this need not be the case. There exists no minimum and no maximum although it is usually €1 and often there is no real reason to have it any other way, but cases do exist. The shares between shareholders need not be identical, and different shareholders can be issued shares with different nominal values.

"The true value of a share does not usually correspond to the nominal value of a share (plus premium, if any, paid thereon). A share with a nominal value of €1 may, for example, four or five years after its issue, be worth a hundred times that amount if in the meantime the company becomes hugely successful and has a lot of retained earnings. On the other hand, a share with a nominal value of €100 may be completely worthless if the company becomes insolvent. Moreover, fluctuations in the value of shares may occur, sometimes even significantly, over a short period of time. It is only at the time of a share issue that the value of the shares usually (but by no means invariably) corresponds to the amount payable in respect of the shares. Nor does the true value of the shares in a company usually equate to the value of the underlying net assets. The value of shares often depends to a considerable extent on the number of shares offered by sellers and sought by purchasers at that point in time. Shares representing control of the company will generally command, per share, a higher price than shares representing a minority stake. The articles of many private companies contain pre-emption

[2]"The share capital of a company must, as a general rule, be divided into shares of a "fixed amount". This "fixed amount" is the "nominal" or "par" value of the shares. The nominal value is left to the subscribers' discretion. In Malta, the nominal value in the case of both private and public companies is often Lm1, although it is possible to have shares of any nominal value, whether more, or less, than Lm1. In the case of public companies whose shares are listed on the Malta Stock exchange, the common practice is to have shares with a nominal value of less than Lm1. The minimum share capital requirements however remain the same. Thus, if a private company is to be registered with the minimum issued share capital of Lm500 and wishes to have shares of a nominal value of 10c each, then the company will need to have 5000 shares in issue. Similarly, if the company is to have the minimum issued share capital but wishes to have shares with a nominal value of Lm100 then the number of shares will be five".

provisions requiring a shareholder who wishes to dispose of his shares to first offer them to the other shareholders of the company at a "fair value" to be determined by the auditors of the company. In the case of shares listed on a stock exchange, the value is usually close to the current trading price, although this may not always be representative of the true value of the company".

Share Classes

Ordinary Shares

Thus far, the shares discussed have always been ordinary shares, not preference shares. When shares are issued shareholders have certain rights which are either enshrined in the Companies Act or in the M&A. The main rights that interest us for the purposes of this introductory discussion are as follows:

1. **Voting rights:** Once a company is set up shareholders will attend the Annual General Meeting and there may be Extraordinary General Meetings at which resolutions will also be tabled. Every shareholder has the right to receive notice of the general meeting, to attend, and to vote therein. The voting rights attached to the shares usually are one vote per share held, although this is changeable.
2. **A right to receive dividends:** Dividends are the profits that are available for distribution by a company and are actually distributed to the shareholders. The directors can recommend the distribution of a dividend from the available profits which will then be approved at the general meeting and distributed. Take, for example, a company XYZ Ltd with two shareholders, A and B, holding 10,000 shares of a nominal value of €1 each and 5,000 shares of a nominal of €1, respectively. As a rule, if dividends are to be paid then the amount of dividends paid per share should be the same as long as the nominal value of the shares are the same. Say that the company has turned a profit and that the directors believe it is time to distribute the profit, taking advice from financial advisors as to whether the profits are distributable and there is ultimately €3,000 in distributable profits for dividends. This amount would go into the ratio of the shareholders, in this case 2:1. Therefore, A will receive €2,000 whilst B receives €1,000.
3. **A right to receive notice of, attend, and vote in general meetings.**
4. **A right to a return of capital on the winding up of the company:** If, at a later stage, the company is dissolved and put into liquidation, what the liquidators will need to do is to first pay off the creditors of the company, and if there are any assets remaining then they shall be distributed amongst the shareholders. Take, for example, a company whose total assets before paying off liabilities totals €590,000, and that there are €200,000 in liabilities, leaving €390,000 in assets. These will be distributed to shareholders. Each of the shareholders will first receive the return of the capital they had paid up and the balance will be split according to the ratio.

Preference Shares

With regard to preference shares there exist some fundamental differences. Take, for example, a company which has been set up with two shareholders, one of whom will hold ordinary shares whilst the other holds preference shares. A will have 100,000 ordinary shares with a nominal value of €1 each, whilst B has 100,000 preference shares with the same nominal value. Simply denominating shares as preference shares is meaningless as the memorandum and/or articles of association will need to define which particular rights the preference shares are being allocated. They are often given a preference in respect of two matters, i.e., dividends and of return of capital, with the former being the more important for practical purposes. This works in practice by looking at the content of the M&A which can vary

from one to the other. Say the M&A says that the preference shares have a preferential right to a coupon of 8% of the normal value of the shares. That is to say preference shareholders have a preferential right to receive out of the dividends of the company an amount equal to 8% of the nominal value over and above any right to dividends that the ordinary shareholders may have. If the preference shareholders have an 8% coupon, it would mean that they have on every €1, a preferential dividend of 8c, coming to a preferential dividend of €8,000 p.a. In practice, it may appear that if a preference share has a coupon, it may be advisable to tell one's clients to only invest in preference shares. Although this may not always be advisable. Returning to the previous example, imagine that for three years after starting the company has made some losses but on the fourth year it has generated profits and after recouping the losses has a distributable profit of €7,000 which the directors wish to distribute. The B shareholder has a preferential right to 8% dividends so that amount will go entirely to B and A will receive nothing. However, imagine that the profits are €10,000. What happens then is that the B shareholder will get his €8,000 in full and the remaining balance will go to A. Imagine that the company in the following year makes €30,000, in which case B will take his €8,000, leaving the remaining balance to A.

There are some nuances worth mentioning as far as preference shares are concerned. There is a distinction between cumulative and non-cumulative preference shares. When one is drafting the M&A if either provide for preference shares then it will be important to regulate this issue as to whether the shares are cumulative or non-cumulative. If not, it is said that the shares will be inherently cumulative. Cumulative means that if in respect of any year the preference shareholder does not receive the preferential dividend that he is entitled to, that right to dividend will pass on to the second year and so on until the coupon dividend is paid. Returning to the previous example, remember that for the first three years that the company was unprofitable, it means that the preference shareholder has the right to receive the three unpaid coupons. The M&A may well say that the preferential dividends are non-cumulative in the sense that the right to receive dividends is not passed on.

There is also the notion of participating and non-participating preference shares. Which of the two is present depends on the M&A. A participating preference shares means that over and above the preferential dividend that the shareholder is entitled to, he is also entitled to participate with the ordinary shareholders pro rata or otherwise with any ordinary shares to receive any remaining profits of the company. Take, for example, that same company with €28,000 distributable profits, leaving €20,000 to be distributed after the coupon is paid. This will be split in proportion to the shareholding.

Share Capital Classes

The Authorised Share Capital

"The authorised share capital is the total of the nominal value of the shares which a company may issue. It is the figure which appears in the capital clause of the company's memorandum of association, and it is also the capital which is referred to as "the amount of share capital with which the company proposes to be registered". In the strict juridical sense, this type is not "capital" is it merely represents an authority to create new capital up to its limit by the issue of shares. "Authorised capital" is sometimes also called "nominal capital". A company cannot issue shares in excess of its authorised capital. If the company attempts to do so, the issue will be unlawful and void".

Take, for example, a company incorporated with two shareholders each having 100,000 ordinary shares with a nominal value of €1 each, both having paid up in full. In this case the issued share capital is €200,000 divided into 200,000 shares of a nominal value of €1 each. N.B. even if the shares were partly paid up it would still have the full issued share capital of

€200,000 only partly paid up. The authorised capital is the maximum share capital that can be issued by the company and the authorised share capital clause needs to be included in the memorandum of association. Take, for example, a company with an authorised capital of €500,000 which needs to be divided into 500,000 shares of €1 each but the issued capital is €200,000. Therefore, the company can issue the remaining 300,000 shares at any point in the future.

The authorised share capital may at any stage of the company's existence be altered by an extraordinary resolution altering the memorandum of association. Alternatively, they may opt through the same process to reduce the authorised share capital down to the level of but not below that of the issued share capital. The decision to issue shares in a company once it has been formed is taken by whoever is listed in the M&A although as a rule it is either the shareholders by an ordinary resolution or that power is sometimes delegated to the board of directors by the M&A or by an extraordinary resolution. In that case, it will be the directors who will have the right to issue or allot shares. Because the M&A is a contractual document the shareholders are to agree amongst themselves as to what is included.

Increase in Authorised Share Capital

"Any increase in the authorised share capital of a company requires an alteration to the memorandum of association which can only be affected by means of an extraordinary resolution. The increase in the authorised capital will not take effect unless and until the relative resolution is registered in the [Malta Business Registry]. Together with the copy of the resolution, the company should file a revised and updated copy of the memorandum and articles as altered by the said resolution. Moreover, to make the updated version as "current" as possible, the updated version should also incorporate certain changes that do not, strictly speaking, qualify as alterations to the memorandum and articles but which nevertheless affect the contents of the said documents. Accordingly, the updated version should also include all the changes effected in relation to the directors, company secretary, the representation of the company or any transfer or transmission of shares or any allotment of shares".

The Issued Capital

"The "issued capital" is the total of the nominal value of the shares which are allotted to shareholders. It is that part of the authorised capital actually taken up by shareholders. This information should be included in the share capital clause in the memorandum of association. The difference between the authorised capital and the issued capital is the "unissued capital". Further issues of capital can be made as required in that the company need not issue all its authorised capital at once".

Increase in Issued Share Capital

"An increase in the issued share capital of a company (whether public or private) is, as a rule, to be decided upon by an ordinary resolution of the company, unless the memorandum or articles require a higher percentage than that normally required for an ordinary resolution. The memorandum or articles of association may however permit the general meeting to authorise, by ordinary resolution, the board of directors to issue shares up to a maximum amount as may be specified in the same memorandum and articles. Any such authorisation can be for a maximum period of five years, renewable for further periods of five years each.

"It is quite common, in cases where professional advisers are entrusted with the task of drafting the memorandum and articles of association to reflect their clients' needs, for the memorandum or articles to permit the general meeting to authorise, by ordinary resolution, the board of directors to issue shares. Some memoranda and articles go further and actually authorise the board of directors to issue up to a specified number of shares without the need

for a further ordinary resolution. This practice should be acceptable as the will of the general meeting would be incorporated in the relative clause in the memorandum or articles and would have been approved either unanimously (if included in the original memorandum or articles) or by extraordinary resolution (if included as a subsequent amendment).

“Where such permission is not contained in the company’s memorandum or articles, the same authority may be given to the board of directors by an extraordinary resolution. Where there are several classes of shares, the aforementioned resolutions shall be subject to a separate vote for each class of shareholders whose rights are affected by that resolution or authorisation. A copy of any such ordinary or extraordinary resolution must be delivered to the Registrar for registration within fourteen days from the date of the relative resolution. The aforesaid rules apply to the issue of all securities which are convertible into shares, or which carry the right to subscribe to shares, but not to the conversion of such securities, nor to the exercise of the right to subscribe. Where an increase in the issued share capital is not fully taken up, the issued share capital can be increased by the amount of subscriptions received only if the conditions of the issue so provide.

“As a general rule, any form of application issued by a public company for its shares must be accompanied by a prospectus. The prospectus must comply with the provisions of the Companies Act. The obligation to draw up a prospectus does not however apply in a number of circumstances, that is

(a) in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or the debentures; or
(b) in relation to securities which do not constitute an “offer of securities to the public” as defined in the Act; or
(c) by a holder of a collective investment scheme licence within the meaning of the Investment Services Act provided such issue is made in accordance with rules or regulations made under that Act; or
(d) in the case of an offer where the shares are offered for no consideration and where such offer is made exclusively to existing shareholders, and dividends are paid out in the form of shares of the same class as the shares in respect of which such dividends are paid, provided that a document is made available containing information on the number and nature of the shares and the reasons for and details of the offer; or
(e) in the case of an offer where shares are allotted to existing or former directors or employees by their employer which has shares already admitted to trading on a recognised investment exchange or by an affiliated undertaking, provided that a document is made available containing information on the number and nature of the shares and the reasons for and details of the offer; or
(f) in relation to shares issued on the redemption or reduction of shares of the same class already issued, if the issuing of such new shares does not involve any increase in the issued capital; or
(g) in the case of an offer made in connection with a take-over bid, provided that a document is available containing information which is regarded by the [Malta Business Registry] as being equivalent to that of the prospectus; or
(h) in the case of an offer made in connection with or pursuant to a proposed merger, provided that a document is available containing information which is regarded by the Registrar as being equivalent to that of the prospectus.

The Paid-Up Capital

“The “paid-up capital” is the amount of issued capital which is paid up by the shareholders. This amount is calculated by multiplying the number of shares taken by the subscribers with the corresponding amount paid up in respect thereof. The share capital clause in the

memorandum of association must specify the amount paid up in respect of each share. The money or other value that is transferred by the shareholder to the company and which represents the paid-up capital does not usually lie idle. In the normal course it would be invested in the company's business".

Minimum Percentages to be Paid Up

"In the case of a private company, not less than twenty percent of the nominal value of each share taken up must be paid up on the signing of the memorandum. In the case of a public company, not less than twenty five percent of the nominal value of each share taken up must be paid up on the signing of the memorandum.

"Once a company is registered, the same minimum paid up percentage requirements continue to be applicable in respect of any further issues of shares – that is, in the case of a private company shares are to be paid up on allotment to at least twenty percent of their nominal value, and in the case of a public company shares are to be paid up on allotment to at least twenty five percent of their nominal value. Moreover, the amount or value of any premium must be paid in full. The Maltese rules contrast with the position in English law in two respects: first, under English law no minimum percentage paid up requirement applies to shares issued by private companies, but in the case of a public company at least twenty five percent of its nominal value has to be paid on allotment; second, under English law it is only in the case of public companies that the whole of the premium is to be paid up before or concurrently with the allotment".

The Called-Up Capital

"Called-up capital" is not defined in the Companies Act. The notion is however defined in English law as "so much of [the company's] share capital as equals the aggregate amount of the calls made on its shares (whether or not those calls have been paid), together with any share capital paid without being called and any share capital to be paid on a specified future date under the articles, the terms of allotment of the relevant shares, or any other arrangements for the payment of those shares". The close affinity between the notions of share capital in English and Maltese law suggests that the same meaning should be afforded to the term "called-up capital" in Maltese law. Given, however, that the term is used in some important provisions in the Companies Act, the inclusion of a statutory definition (along the lines of the English definition) is called for as a matter of some urgency.

Topic IV: Capital Maintenance

Minimum Authorised and Issued Share Capital

“A company is required to have a minimum authorised share capital as well as a minimum issued share capital. Different minimum capital requirements apply, depending on whether the company is a private company or a public company. A private company is required to have a minimum authorised share capital of Lm500 whilst in the case of a public company the minimum authorised share capital is Lm20,000. Where the authorised share capital is equal to this minimum, ‘it shall be fully subscribed in the memorandum’ and where it exceeds this minimum, ‘at least that minimum shall be subscribed in the memorandum’. This effectively means that the minimum issued share capital of a private company is Lm500 whilst that of a public company is Lm20,000. The minimum share capital requirement also applies when a company is re-registered as a public one.

“The higher minimum issued share capital for a public company was probably included in the Companies Act in anticipation of the need to implement article 6 of the Second EC Directive on share capital and the classification of companies, which requires a minimum capital of not less than €25,000 for public companies. Article 6 of the Directive was intended to allay the concern that discrepancies between the various EU Member States on this matter would affect freedom of establishment and channel capital to those countries with the most liberal regimes. The higher minimum capital requirement for public companies may also reflect an expectation that public companies should possess a greater measure of substance than the typical Lm500 private company.

“In English law there is no minimum issued capital requirement except in the case of public companies. Public companies must have an “authorised minimum” share capital of £50,000 or such other sum as the Secretary of State may specify by statutory instrument. A company formed as a public company cannot commence business or exercise any borrowing powers unless it satisfies the Registrar (who then issues a certificate to that effect) that it has issued and allotted shares to the nominal value of not less than the authorised minimum, of which at least one quarter and the whole of any premium has been paid up either in cash or (subject to an independent valuation and within certain limits) in kind. The Registrar must also be satisfied that these conditions are met when a private company is re-registered as a public one. If a company does business or exercises borrowing powers without the aforesaid certificate, the company and any of its officers who are in default are liable to a fine, but the validity of any transaction entered into by the company will not thereby be affected.

“On an initial consideration, the rationale behind the statutory minimum capital requirements may seem to be the protection of creditors. The law appears to presume that the creditors look to the issued capital as a fund for their protection in the event of the company’s insolvency. On reflection, however, it will be realised that any such purpose is wholly unrealistic. The amount of issued capital required cannot be such as to offer much (if any) protection to creditors. As pointed out by a Kentucky court, “one may start business on a shoestring in Kentucky, but if it is a corporate business the shoestring must be worth one thousand dollars”. The same criticism can obviously be levelled at the Maltese minimum capital requirement for a private company. But even the figure of Lm20,000 in the case of a Maltese private company (and that of £50,000 in the case of an English company) are entirely arbitrary and cannot be regarded as measures intended to effectively protect creditors. Indeed, in no way are they related to the nature of the business to be undertaken by the company or the company’s financial structure. Rarely, the figures may prove to be excessive. More often than not, however, the figure will be “derisively small”. And even if the original minimum capital requirement is adequate, there can of course be no guarantee that the capital will remain intact for it can be easily eroded through trading losses. Indeed, a company (private or public) can

be incorporated with a high issued share capital (say of Lm5,000,000) and become insolvent shortly thereafter. On the other hand, a company may be registered as a private company with the minimum issued share capital of Lm500 and, after a few years of successful trading, become a thriving company with a solid net asset base.

"It is evident that other factors – not creditor protection – explain the presence of the minimum requirements. The main consideration, both in the case of Maltese and English law, leading to the introduction of the minimum capital requirement rules for public companies was the implementation of article 6 of the Second EC Company Law Directive, rather than a deeply felt domestic belief that the requirement would offer protection to creditors.

"The absence of a general statutory requirement for a reasonable level of minimum capitalisation has often been severely criticised. Usually, the commentator's tack is to first highlight the "disturbing" situation where an insolvent company with a very low issued share capital ends up with very significant debts and to then argue that the case for a reasonable minimum capital requirement is therefore "virtually unanswerable". For a number of reasons, however, reform on the basis of a pre-determined statutory minimum share capital would be inappropriate. These reasons are discussed presently.

"First, it is evident that one company's financing requirements may vary immensely from another company's needs. A hotel development project may require several millions of liri worth of investment whilst a little stationer may only need a few thousand liri. It is therefore impossible to pre-determine a "reasonable" amount as a statutory minimum requirement. Indeed, any statutory minimum would be too arbitrary and therefore meaningless: inevitably, it would be too low for some ventures and too high for others. It would be an "empty ritual" fooling no one. clearly, minimum capitalisation is a problem that goes beyond the capacity of a general statutory provision based on pre-determined limits.

"Second, calls for a statutory minimum capital requirement appear to ignore the fact that other methods of financing (for example short- and long-term debt) may be beneficial to the company without undermining the interests of creditors and without abusing of the privileges of incorporation and limited liability. The truth is that a company's financing need not all be "risk" capital.

"Finally, the notion of a minimum share capital appears to be based on the wrong economic assumption that the capital will remain unimpaired. In practice, of course, the capital may be diminished or lost through the company's normal trading activities. The law cannot guarantee that this fund will remain intact when the creditors need to have recourse to it, although the doctrine of capital maintenance does reduce the risk of the capital being depleted, say, by improvident dividends. All told, statutory minimum capital requirements hardly ever serve as an effective palliative.

The Doctrine of Capital Maintenance

The word 'capital' with regard to company law can have a number of meanings. When dealing with LLCs the focus is on the share capital and the M&A must have included in it a capital clause. Share capital, meanwhile, can be defined as a partial or whole stake in a company bringing with it particular rights within the company. Share capital is to be distinguished from other forms of capital, such as loan capital or equity. Loan capital, then, is a right against the company in the sense that the lender has the right to enforce its loan against the company. The word 'maintenance' means that a particular amount of share capital is to be kept in reserve. One of the main issues to be considered is whether a company should be free to do whatever it likes with its capital, provided that it is solvent (i.e., a company with more assets

than liabilities), or should a company be restricted by capital maintenance rules? There are arguments to be made for both sides. In truth, today, there are provisions in the Maltese company law that actual restrict the company's freedom when it comes to share capital. However, most text writers are against these rules because they are "paternalistic", according to Paul Davis. These restrictions are not conducive to achieve the objective they purport to obtain.

One must appreciate that the rules on capital maintenance were developed in order to protect creditors once we had the creation of limited liability companies. In an LLC, shareholders have limited liability and as such they pose a threat to creditors who often remain unpaid in the result of an insolvency. Most textbooks explain that with the advent of limited liability the courts' concern turned to the protection of creditors. To put it in a brief manner, there developed the doctrine of capital maintenance which essentially is a collection of rules designed to ensure two main objectives: first, that a company obtains the capital it has purported to raise; and second, that the capital is maintained subject to the exigencies of business for the benefit and protection of the company's creditors. In particular, the doctrine on capital maintenance precludes the return of capital, directly or indirectly, to the shareholders ahead of the winding up of the company (*vide* Title V of Part II of the Companies Act). In a winding up process the manner that creditors are paid out is strictly regulated and it is only once all the creditors are paid according to their ranking at law that the shareholders can be paid back their original subscription. What these capital maintenance rules are trying to achieve is that shareholders are only paid last since, as owners, they have additional duties.

One eminent English text writer, John Armor, quotes from the Company Law Review Document, referred to as strategic framework, and capital maintenance is described as a *"narrow and technical issue concerning the preservation of certain reserves which are currently designated as not normally distributable to members".* This view is also shared by Paul Davis who, in his work *Introduction to Company Law,* is highly critical of the capital maintenance doctrine and states that "*there is reason for thinking that, at least historically, the capital maintenance rules have not aimed at reducing contracting costs, but rather have reflected a more paternalistic approach to the use of the law to regulate the affairs of companies".*

One argument that is brought to justify these rules is that through them the law is keeping costs between the parties at a low because essentially the law is giving a minimum threshold of protection to creditors. However, text writers like Paul Davis argue that in practice this object is rarely achieved and what is actually happening is that there is an element of paternalistic intrusion in the affairs of the company.

The Relationship Between the Rules and the Restriction on the Company's Freedom to Contract

An argument brought to support the rules on capital maintenance is that it would be pointless if the company having raised legal capital were free to conduct itself subsequently in total disregard of its legal capital. There are various issues that come into play here. The first is whether the company is actually completely free to part with its assets, even though the value of the company's assets will then be less than that stated in its balance sheet as the value of its capital. The criticism that is levelled when it comes to this restriction is that, as a rule, it could hardly be applied to all corporate transactions, because the danger would be that once the company's assets fall below the value of its capital it would have to cease trading. In actual fact, what the law is trying to restrict is the freedom of a company to make distributions to its members if the value of the assets would then be below its capital yardstick. Therefore, the amount of a company's legal capital plays an important function of limited the company's

freedom to return assets to its shareholders. The restriction is therefore that a company in principle cannot return the share capital to the shareholders unless it is being wound up.

The second issue that is targeted by this set of rules is what freedom the company has to adjust downwards the amount of legal capital after it has raised it. The conundrum here is that if a company were entirely free to make this adjustment the rules on distributions would become meaningless as, essentially, the company would simply be put through the trouble of making that adjustment before it carried out the distribution. However, in certain other circumstances there may be good reasons why a company ought to be permitted to reduce its capital. The result being therefore that the crucial question becomes one of the defining circumstances in which the value of the legal capital in its balance sheet is reduced. Although in general it is good to follow restrictions, there may be some justifiable reasons to allow a company to reduce its share capital. The law must strike a balance which is struck in practice by defining the actual circumstances, i.e., the exceptions to the rule, where a legal capital of a company may be reduced. *In fine,* the rules on capital maintenance restrict the freedom of the directives or the management of the company to move assets out of the company and into the hands of the shareholders.

The *raison d'être* for these restrictions in the context of a limited liability regime is arguably that of the protection for creditors, although this objective is rarely achieved. What the law is trying to achieve through these laws is that, in that the provisions in the Companies Act are trying to replicate for the company when it is a going concern the principles which apply in an insolvency. In an insolvency scenario, shareholders are entitled to payment only if the creditor's claims have been met, meaning that as near can be with a going concern the result is replicated by requiring that the company's net assets exceed the value of the shareholders contributions before and immediately after a distribution of assets is made to the company's members. In this brief segment, we have analysed the relationship between the rules on capital maintenance and the restrictions placed on the company.

The origins of this doctrine

Like most aspects of company law, we can trace back its origin to English court judgements which developed these judgements in furtherance of the law of precedence. The case recognised as the landmark in this doctrine is that of *Trevor v. Whitworth* (House of Lords, 1887) wherein the company bought back almost a quarter of its own shares (a stock buyback). Subsequently, during the liquidation process one shareholder applied to the court for the balance of amounts owed to him after the buyback. The court of appeal was of the opinion that he should be paid, whilst the House of Lords held that the buyback was *ultra vires* the company and that the company could not purchase its own shares even though there was a provision to this effect in the M&A since this would result in a reduction of capital. It also held that there can be no return of capital to the members other than on a proper reduction of capital duly sanctioned by the court. That is to say, when we say that *Trevor v. Whitworth* laid down the rules of capital maintenance it did so because the company's management did not follow the proper procedure as any reduction in capital must be sanctioned under the auspices of the court. This judgement is largely recognised as having set out the principle on capital maintenance and has subsequently been applied both by the courts and included in statutory provisions. Again, the objective of the capital maintenance rules has always been taught to be the protection of creditors who are entitled to assume that a risk of a loss of the company's capital is confined to ordinary commercial activity. *Trevor v. Whitworth* originated the principle of capital maintenance. Today, the position in the UK has been modified into a more relaxed stance due to the necessities of modern business demands.

The various rules governing capital maintenance in Malta

The next step would be to try and classify the scenarios provided by Maltese company law into two broad categories. The rules include:

1. Rules as to the payment for share capital which are designed to ensure that the company obtains the capital, which is has purported to raise,
2. Rules prohibiting the return of capital to its shareholders,
    a. Scenario A: There can be no purchase by a company of its own shares (*vide* article 105 of the Companies Act subject to the modifications to allow for the purchase and redemption by a company of its own shares provided that this is done in accordance with the statutory scheme set out in articles 106-110 of the Companies Act),
    b. Scenario B: There can be no reduction of capital other than on the basis of the statutory scheme requiring the confirmation of the court (*vide* article 83 of the Companies Act),
    c. Scenario C: A company cannot provide financial assistance for the purchase of its own shares (*vide* articles 110 of the Companies Act),
    d. Scenario D: No dividend is to be paid out of capital (*vide* the judgement of *Re-Exchange Banking Co. Flitcroft Case* (Chancellor Division, 1882).

With respect to these provisions in Scenario C there is an academic debate as to the precise relationship between the doctrine of capital maintenance and its goal of creditor protection. The principle of financial assistance as provided for in article 110 addresses wider concerns, such as appropriate methods of funding, corporate acquisitions, and share price manipulation. Scenario D is today part of a broader prohibition on the distribution of the company's assets to its members other than out of its distributable profits.

Linked to the prohibition on the return of capital to the members is an equal prohibition on giving away the company's capital to non-members through a gratuitous disposition. This has been explained in the judgement *Brady v. Brady* (1988). The principal is that *"a company cannot give away its assets. So stated, it is subject to the qualification that in the realm of theory a memorandum of association may authorise a company to give away all its assets to whomsoever it pleases, including its shareholders. But in the real world of trading companies, it is obvious that such a power would never be taken. The principle is only a facit of a wider rule, the corollary of limited liability that the integrity of a company's assets, except to the extent allowed by its constitution, must be preserved for the benefit of all those who are interested in them, most pertinently, its creditors".* This provides us with a clear definition on what lies at the heart of the rules of capital maintenance.

The general effect of such prohibitions is such that it leads us to another issue needing to be addressed by raising the question as to whether the current capital maintenance rules can be defended on the grounds that they accurately predict the result the contracting parties would have arrived at and thus reduce transaction costs. That is to say, with the law providing for this restriction, we have ingrained in the law a minimum protection for creditors which is interpreted as protecting creditors because unless this minimum protection would have been included in the law the creditors themselves would have to negotiate this basic protection between themselves. This negotiating process would involve additional expense so it is argued that the rules on capital maintenance can be protected because by providing this minimum protection it is in fact helping them reduce their costs. However, do they truly achieve this protection in practice? Most text writers agree that it might be said that even where the rules aim at the right target and do so through appropriate means, they are not sufficiently flexible to produce the equivalent of a bargained-out solution (that term used by text writers to

describe the negotiating process between creditors, i.e., the bargain theory of creditor protection). Whilst the rules are actually properly drafted, they therefore claim that they remain inflexible. However, by and large, those that favour the rules on capital maintenance argue that the law provides a minimum level of protection, and it is then up to creditors to bargain for greater protection if they wish to achieve it.

In order to better understand the rules on capital maintenance it is of the utmost importance that one refers to Chapter V of the Companies Act. Article 104 lays down the duty of directors on the serious loss of capital:

> **104.** (1) *Where the net assets of a public company are half or less of its called-up issued share capital, the directors shall, not later than thirty days from the earliest day on which that fact is known to any director of the company, duly convene a general meeting of the company by means of a notice to that effect for a date not later than forty days from the date of the notice for the purpose of considering whether any, and if so, what steps should be taken to deal with the situation, including consideration as to whether the company should be dissolved.*
>
> *In this sub-article, "net assets" shall have the same meaning assigned to it under article 193(2).*
>
> (2) *In a meeting convened in pursuance of sub-article (1), only the steps mentioned in the said sub-article may be considered.*
>
> (3) *If a general meeting as required by sub-article (1) is not convened, each of the directors of the company in default shall be liable to a penalty, and, for every day during which the default continues, to a further penalty.*

Article 105 lays down the principle that a company cannot subscribe to its own shares.

> **105.** (1) *A company shall not subscribe for any of its own shares, whether on original subscription or on any subsequent subscription, and if any of its shares have been subscribed for by a person acting in his own name but on behalf of the company the subscriber shall be deemed to have subscribed for them for his own account.*
>
> (2) *On the registration of a company, the subscribers to the memorandum shall be jointly and severally liable to pay for the shares subscribed in contravention of sub-article (1).*
>
> (3) *In the case of an increase in the issued share capital, the members and directors shall be liable jointly and severally to pay for the shares subscribed in contravention of sub-article (1) provided that any member or director may be released from such liability if he proves that the breach occurred through no fault of his own.*

Articles 106-110 deal with the statutory exceptions to the rule set out in article 105. Article 106 lays down the conditions under which a company may acquire its own shares.

106. (1) *Without prejudice to the principle of equal treatment of the shareholders who enjoy the same rights in respect of the shares held by them and to any relevant provisions of the Prevention of Financial Markets Abuse Act, a company may acquire any of its own shares otherwise than by subscription, provided all the following conditions are respected -*

(a) *provision is made by the memorandum or articles of the company for authorising the acquisition by the company of its own shares;*

(b) *authorisation is given by an extraordinary resolution, which resolution shall determine the terms and conditions of such acquisitions and in particular the maximum number of shares to be acquired, the duration of the period for which the authorisation is given and which may not exceed eighteen months and, in the case of acquisition for valuable consideration, the maximum and minimum consideration;*

(c) *the provisions of article 135 shall apply in respect of the extraordinary resolution referred to in paragraph (b) above subject however to the condition that shares already held by the company itself shall be treated as carrying no voting rights;*

(d) *the nominal value of the acquired shares, including shares previously acquired by the company and held by it shall not exceed fifty per cent of the issued share capital;*

(e) *no acquisitions by a company of its own shares shall be made when on the closing date of the last accounting period the net assets as set out in the company's annual accounts are, or following such distribution, would become lower than the amount of called up issued share capital plus those reserves which may not be distributed under the provisions of this Act or the company's memorandum or articles; and in any case it shall not be possible for the company to acquire any of its own shares except out of the proceeds of a fresh issue of shares made specifically for the purpose, or out of profits available for distribution;*

(f) *the shares acquired shall be fully paid up shares; and*

(g) *a company may not as a result of the acquisition of any of its shares become the only holder of its ordinary shares.*

(2) *The company shall deliver to the Registrar for registration a copy of the resolution mentioned in sub-article (1). If default is made in complying with the provisions of 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.*

> (3) *The provisions of sub-article (1)(b) shall not apply where the acquisition of a company's own shares is necessary to prevent serious and imminent harm to the company.*
>
> (4) *The provisions of sub-article (1)(b) shall furthermore not apply to shares acquired either by the company itself or by a person acting in his own name but on the company's behalf for distribution to that company's employees or to the employees of its parent company or of any of its subsidiary undertakings. Such shares shall be distributed within one year of their acquisition.*
>
> (5) *References in this article and in articles 107 to 110 to a company holding, acquiring, or otherwise dealing in its own shares shall be deemed to include references to the company so doing either itself or through a person acting in his own name but on the company's behalf.*

Article 107 deals with the acquisition of its own shares by a company without the application of article 106.

> **107.** (1) *A company may acquire any of its own shares otherwise than by subscription without complying with the provisions of article 106, other than sub-article (1)(g) thereof, where the shares are -*
>
> (a) *acquired by the company in the course of a reduction of the issued share capital made in accordance with article 83; or*
> (b) *the subject of an application which is revoked in accordance with the provisions of article 100; or*
> (c) *forfeited or surrendered in accordance with the provisions of article 112; or*
> (d) *acquired in any procedure for the conversion, the amalgamation, or the division of companies pursuant to the provisions contained in Part VII, Part VIII and Part IX, respectively, of this Act; or*
> (e) *acquired in any procedure for the change of status of a company pursuant to the provisions of article 213; or*
> (f) *acquired by the company pursuant to an order of the court made under the provisions of this Act for the re-purchase of shares held by dissenting shareholders, including any order made in terms of article 402(3)(d); or*
> (g) *fully paid up and acquired by an investment company with fixed share capital or by another company forming part of the same group at the member's request provided that such acquisitions shall not have the effect of reducing the company's net assets below the amount of the issued share capital plus any reserves the distribution of which is forbidden by law;*
> (h) *acquired by the company during a redemption of preference shares in accordance with article 115.*

> (2) *Where shares acquired pursuant to sub-article (1)(b) to (f) are retained by the company and are not disposed of within thirty months of their acquisition the company shall by extraordinary resolution cancel such shares within six months of the expiry of the said thirty months.*
>
> (3) *The provisions of article 83 dealing with the reduction of issued share capital shall apply where shares are cancelled pursuant to sub-article (2):*
> *Provided that the court may not disallow the cancellation but, if good cause is shown, it shall only order that sufficient security be given to the creditor who had objected to the cancellation, and if sufficient security is not immediately available, the court shall order the provision of such security immediately it becomes available to the company and no distribution of dividend may be effected by the company in the meantime:*
>
> *Provided further that this sub-article shall not apply where the company has acquired the shares otherwise than for valuable consideration.*
>
> (4) *If the company fails to comply with sub-article (2) within the time limit prescribed, any member or director of the company may apply to the court for an order that such shares be cancelled.*
>
> (5) *Where the nominal value of the shares held by the company in pursuance of any of the provisions of sub-article (1), including shares which the company may have acquired through a person acting in his own name but on behalf of the company, does not exceed ten per cent of the issued share capital thereof, the provisions of sub-articles (2) to (4) shall not apply.*

Article 108 deals with a scenario where shares are acquired or held in contravention of articles 106 and 107 of the Companies Act.

> **108.** (1) *If shares acquired or held in contravention of article 106 and of article 107(1) are not disposed of within one year of their acquisition, the company shall cancel such shares within six months of the expiry of the said year.*
>
> (2) *Where shares are cancelled pursuant to sub-article (1) the provisions of article 83 shall apply subject to the proviso to article 107(3).*
>
> (3) *If the company fails to comply with sub-article (1) within the time limit prescribed, any member or director of the company may apply to the court for an order that such shares be cancelled.*

Article 109 sets out the conditions for the acquisition by a company of its own shares where it is permitted by law.

109. *During the time that a company holds any of its own shares –*

(a) *they shall carry no voting rights notwithstanding any provisions to the contrary in the company's memorandum or articles; and*

(b) *if the shares are included among the assets of the company shown in the balance sheet, a reserve of the same amount, unavailable for distribution, shall be included among the reserves.*

Article 110 lays down detailed provisions regulating a scenario where an undertaking may not subscribe or acquire shares in its parent company or provide financial assistance for the purchase of its own or its parent company's shares.

110. (1) *It shall not be lawful for an undertaking -*

(a) *to subscribe for, hold, acquire, or otherwise deal in shares in a company which is its parent company; or*

(b) *to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of an acquisition or subscription made or to be made by any person of or for any shares in the company or its parent company.*

(2) *The provisions of sub-article (1) shall not apply to transactions effected with a view to the acquisition of shares by or for the company's employees or the employees of a group company:*
Provided that such transactions shall not have the effect of reducing the net assets of the company below the amount specified in article 106(1)(e).

(3) *Sub-article (1) shall not apply to the provision of financial assistance by an investment company with fixed share capital for the purpose of or in connection with the acquisition of its fully paid up shares by another undertaking:*

Provided that such provision of financial assistance may not have the effect of reducing the net assets of the company below the amount specified in article 106(1)(e).

(4) *The provisions of sub-article (1)(b) shall not apply if the company granting the financial assistance is a private company and the following requirements are fulfilled:*

(a) *the Board of Directors has, after taking into account the financial position of the company and the obligations of the directors as set out in article 136A, resolved by the affirmative vote of a majority of all the directors forming the Board at the time of the particular resolution, to authorize the grant of financial assistance for a specific transaction;*

> (b) *an extraordinary resolution has been passed affirming the resolution taken pursuant to paragraph (a); and*
>
> (c) *a declaration in the prescribed form signed by two directors confirming that the requirements set out in paragraphs (a) and (b) have been satisfied is duly filed with the Registrar prior to the granting of the financial assistance, and the signature of one director shall suffice where the Board is composed of only one director.*

It is argued that despite the significance which other financial facts about the company may have for creditors, corporate law still regards a company's statement about the level of assets which have been contributed by the shareholders to the company in exchange for shares as an important element for creditor protection. This is not unique to Malta, with British law and the EU's Directive II both reflecting this fact. However, the capital maintenance rules operate so as to restrict the freedom of companies to adjust their share capital or to carry out reorganisations involving share capital. The current view is that the domestic rules as reinforced by the second directive are unduly restrictive and ought to eb relaxed, especially in the areas of reduction of capital and financial statements. When it comes to the validity of share capital in the protection of creditors there is a lot of doubt and, returning to the Company Law Review (*Company Formation and Capital Maintenance* 1999) the conclusion seems to be that stakeholders use other tools to assess the creditworthiness of a company. Therefore, the modern challenge is to rationalise the current confused picture into a more transparent and cohesive body of rules and accepting that the rules of capital maintenance today have a function that is broader than the protection of creditors. An initial step might be to drop the label 'capital maintenance' and rebrand these rules as constraints on the unauthorised dissipation of assets to better describe their ultimate objective.

Topic V: The Memorandum and Articles of Association

To begin with, the M&A are actually two different documents. Although very often lawyers refer to them collectively and are treated for practical purposes as one document. However, there is a fundamental distinction between the two. In terms of the Companies Act the Memorandum must contain certain details and if such details are not there the registrar will not register the company. The Memorandum must contain the following:

1. **The name of the company clause:** A company must have a name and by and large one can choose any name subject to restrictions, e.g., the use of the suffixes LTD, PLC, etc. There are also restrictions on the choice of word, e.g., if it is confusingly similar to the name of another company (one can apply to reserve a name up to three months before the registration), if it is otherwise obscene or vulgar, etc.
2. **The nature of the company clause:** Whether it is private or public; appears to be superfluous as the name of the company itself would indicate this fact.
3. **The registered office clause:** Every company in Malta must have a registered office in Malta which must be an actual physical location, not a PO box. This is necessary to know because companies, strictly speaking, have no physical existence, and it is necessary for them to be reached physically for particular correspondence. This registered office need not be the place of business from which the company is run; as a matter of fact it need not be a place of business at all.
4. **The objects clause:** Every company must in its M&A set out what its objects are going to be. One could have an objects clause that is very wide-ranging (e.g., software development, operation of restaurants, consultancy, manufacture of shoes, etc.), or one could choose to restrict their objects clause. When shareholders get together, they usually get together for a particular type of venture. Issues relating to this clause are what if a company enters into a transaction that goes beyond the objects set out in the M&A. This brings us to the notion of *ultra vires* and there the law gets complicated.
5. **The share capital clause:** The memorandum needs to set out what the share capital of the company is. The law states that a company needs to have a share capital divided into shares of a fixed nominal value and the number of shares needs to be set out in the memorandum and the fixed nominal value too. Also, the amount paid-up of shares must also be disclosed. The capital clause also needs to identify what the authorised capital is and what the issue share capital is.
6. **The subscribers' clause:** This discloses the subscribers, i.e., those who signed the M&A and are the first members of the company. Every single member will need to sign the M&A at this stage. It must also identify their names, addresses, nationalities, and passport numbers if they are individuals and the names of the companies, their registration numbers, and their registered addresses if the shareholders are companies.
7. **The management clause:** This clause identifies the composition of the board of directors and is usually divided into sections: the first states the number of directors on the board (typically indicated as a range); the second actually identifies who the first directors are, offering their names, addresses, passport numbers, and nationalities. Although directors are very often individuals, a company can itself act as a director.
8. **The representation clause:** The M&A has to set out how the representation of the company is to be exercised. Here, there is a distinction between what we call legal and judicial representation. The purpose of this clause is so third parties will be able to know who they can deal with in contracts or lawsuits.
9. **The company secretary:** The company must have a company secretary and they must be duly identified, be they an individual or a company. A company may have one or more company secretaries. The Registrar may require the full residential address

as well as the identity card or passport number of the listed person pursuant to article 69(1)(h).

10. **The duration clause:** The company will be set up for an indefinite period of time in the absence of such a clause although the M&A may stipulate a time period for the company's existence, at the expiry of which it will dissolve.

The Articles of Association

The main distinction between the memorandum and the articles of association is that, as a rule, what goes into the memorandum is what is required by law, and it is also what primarily is of interest to third parties dealing with the company. On these two points on the memorandum, the Companies Act requires about ten clauses to be included and if one is left out the company will not be registered. The fact is that these clauses are primarily of interest to third parties dealing with the company, take, for example, the need to know where to send correspondence, whether the company can actually enter into the type of proposed transaction, who the directors are and who is empowered to represent the company, who the shareholders are.

In re the articles of association they regulate the internal relations of the company, i.e., the relationship between the shareholders *inter se* and in between the shareholders and the company, and that between the shareholders and the directors. More than that they regulate certain procedures within the company, and it is said that what goes into the articles is not of any real concern to third parties dealing with it. The law does not offer a defined list of types of clauses that must go into the articles, but what the law does provide is a specimen articles of association and therefore we have a first inkling in the law itself of what should be expected to go into the articles. This model articles of association is found in the first Schedule of the Companies Act. The drafters of the articles have a choice between three options when it comes to the way in which they will draft it: first, to adopt lock, stock, and barrel the specimen articles suggested by the law itself and nothing else other than a one liner that the articles of association of the company shall be those incorporated in parts I and II of the first schedule. In practice this never happens because more often or not there will need to be some change or other to the model articles proposed by the law. Second, to adopt the articles set out in Schedule I and to say so, whilst saying *"save as hereinafter set out"* which shall be followed by a number of clauses tailor made to the company concerns. Therefore, the model articles of the law shall apply save for the few agreed upon exceptions. Third, which is now the most commonly used option, is to have a standalone set of articles of association, i.e., there will be no incorporation to the model articles set out in the law but to have a self-containing article of association that would cover a lot of the ground covered in the model articles. A note will also be included stating that the model articles of the law will not apply. The idea of having the model articles apply as amended by another document makes for laborious reading and occasionally lack of clarity.

What typically goes into the articles of association is as follows:

1. **Provisions dealing with a fresh issue of shares:** The company can begin with a small share capital or a particular amount, but it can at a later stage increase the share capital by issue further shares and the articles describe the procedure to be followed, including clauses setting out pre-emption rights (i.e., rights that are given to the existing shareholders to purchase themselves any new issue of shares)
2. **Provisions dealing with share transfers:** Once a company is set up it will gather shareholders and the question that arises is what if a shareholder wishes to transfer his or her shares. The articles will explain the procedure which needs to be followed and there is no hard and fast rule. Very often any shareholder wishing to transfer his

shares in the company will first have to offer them to the other shareholders *pro rata* to their holding. Furthermore, it is usually provided that the price at which the shares are offered will need to be provided by the auditors of the company. There will also be other provisions regulating what happens if the other shareholders do not wish to take up the offer to purchase the shares, e.g., the process and pricing for offering the shares to outsiders, whether the board of directors must approve transfers to outsiders, whether shares sold to outsiders can be priced differently, etc.

3. **Provisions regulating meetings:** Meetings that take place within a company are meetings of the shareholders called general meetings and meetings of the directors called board meetings. There will be quite a number of provisions dealing, *inter alia*, with notice requirements, quorum requirement, how resolutions are to be taken and what majority will be required to pass the resolution. In the case of directors' meetings, the rule is generally that decisions require a majority vote, but the articles are a contractual document and the parties, *viz.*, the original subscribers, are free to have the articles drawn up in whichever way they please. These provisions also regulate the appointment of the chairman and the managing director and whether or not either be given a casting or additional vote to avoid situations where deadlock would otherwise arise. The distinction between a second or casting vote is that if the chairman already has a vote, he may be given a second vote but at times, although it is rare, the chairman may not already have a vote, such as in the case of shareholders' meetings, in which case he will be given a casting vote.

In the memorandum one has to include those provisions that are required by law to be included in the memorandum and if this were not the case the company would not be registered. If two of those prescribed clauses were put in the articles instead it still would not be passable. That said, if those provisions typically included in the articles of association be placed in the memorandum it would not be problematic. As a rule, any amendments or revision to the memorandum or articles requires an extraordinary resolution of the shareholders because the company belongs to them, and the original M&A would have been drafted on their instructions. The question that then arises is whether the law requires changes to be agreed to by all the subscribers, with the answer being no. As a rule, an extraordinary resolution is one passed by shareholders with at least 51% nominal value of the shareholding of the company. What is sometimes included in the M&A is a provision saying that an extraordinary resolution amending the M&A would require a higher threshold of nominal value and may even require unanimity. There, the professional advisor plays a very large role because he has an important function to make sure that the shareholders understand what the implications of their signing are and one such implication is what majority can alter in the future the memorandum or articles. Whether or not approval to the amended M&A by the authority in question is required depends on the type of company and under which authority the company is registered, although usually no prior approval is required.

Alterations to be Affected by Extraordinary Resolution

"The general principle is that a company may "by extraordinary resolution alter or add to its memorandum or articles". The law, quite logically, vests the power to alter the memorandum or articles in the hands of the members, who after all are the owners of the company. There is however, one exception to this rule: if the alteration consists in a change of the registered office in Malta of the company, such alteration may be affected by a resolution of the directors. It is not entirely clear why the law should make this sole exception. The reason may be that a change in the location of the registered office in Malta is not a fundamental matter which in any way affects the rights of the shareholders. Seen in this light, a change in the location of the registered office should therefore be within the powers of the directors, thereby avoiding

any possible inconvenience, delay, and expense associated with the calling of a general meeting to decide on the matter.

"The Companies Act also provides that where the alteration consists in the conversion of any shares into stock or in the reconversion of that stock into shares, such alteration may only be made if the shares to be converted are paid up shares and of the stock is reconverted into paid up shares. Moreover, if the company is so authorised by its memorandum or articles, it may by *ordinary* resolution convert into paid up shares into stock and reconvert that stock into paid up shares of any denomination".

Topic VI: The Key Features of the Corporate Structure

The Shareholder-Board Relationship

The concept of centralised management had evolved in the middle of the 19th century because at that point the idea of a company with thousands of shareholders had begun to be a reality and it would have been impossible to have them all involved in the decision-making process. Therefore, the solution was to appoint a board of directors to manage the company's affairs. It is not the case that the board of directors has to be composed of individuals who are different from the company's shareholders. In fact, a company's shareholders may well have appointed as directors their fellow members. This scenario is quite common with relatively small family companies. If it were to have a larger number of shareholders, it is very unlikely to have them all on the board. The board itself may be populated by external directors with no connection to the company's shareholding.

When it comes to the decision-making process in a company, who is empowered to take decisions? Take, for example, the following four proposed decisions: first, to put the company into liquidation; second, to expand on the objects clause of the company; third, to employ two new employees; fourth, to take on a new loan from a bank. How is it determined who is to take such decisions? The answer is found in article 137(3) of the Companies Act which states as follows:

> (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.*

When one comes to determine whether a particular proposal needs board approval or general meeting approval this principle of article 137(3) must be taken into account. Take, for example, the question of employing the two additional employees; does the Companies Act require such a decision to be taken by shareholders? It does not. Next, does the M&A of this particular company require the decision to be taken by shareholders? If not, that decision can be taken by the board of directors. Returning to the example of liquidation, this process is repeated. The law regulates liquidation and requires shareholder approval; therefore, one can stop the process there. With regard to the proposal to take on new banking facilities, the law includes no such provision, but the particular company's M&A may do so.

With regard to the director appointment process, a distinction must be made between the first directors and subsequent ones. The former is always appointed in the memorandum such that when it is being drafted one of the clauses that needs to be included is the management clause which shall include the personal information of the first directors. It does not mean that the first directors will necessarily be directors themselves for the remaining lifetime of the company. Indeed, a director may cease to hold office for a multitude of reasons. After the company has been set up, future directors are appointed as regulated by the articles of association. Often, a provision will be included stating that directors will retire at the next AGM at which point there will be a new appointment of the board to be made by shareholders at that meeting. Take, for example, four shareholders owning shares in the following proportion: 60%, 15%, 15%, and 10%, respectively. During the incorporation stage the four shareholders, together with the professional advisor, should be discussing the number of directors on the board and how they will be appointed. After an agreement is reached, they may agree as follows: A may request a majority of the board, B and C may offer expertise combined with their shareholding to put them on the board, whilst D is not interested and does not wish to be a director on the board. In order to balance out the interests of the parties they may agree as follows: that A will have

the right to appoint three directors including himself, and that B and C will have the right to appoint one director each. The board will then be composed of five directors including A, B, and C themselves. Alternatively, another example would be a case of two shareholders owning 60% and 40%, respectively. What would often be the case would be the right to appoint two directors being given to A with the right to appoint one being given to B. Although A would have the right to appoint two directors, he need exercise that right immediately.

SMEs

As a general rule, a company should have at least two shareholders. This is only as a general rule and, as shall be seen, the law, since 1995, has allowed the single member company (SME). The Companies Act regulates commercial partnerships. Before it there was the Commercial Partnerships Ordinance and before that the Commercial Code. As the term commercial partnership indicates we are speaking of a partnership with a minimum of two people implied. Hence, this is why for at least 150 years the concept has been that a company had to have a minimum of two shareholders. From the early stages, even of the development of company law, it was also accepted that there was no breach of this rule if one had a company with a shareholder holing 19,999 shares and one other shareholder holding just one share. For many decades when an individual wanted to set up a company that was going to belong entirely to him, knowing however that a company needed a second shareholder, what was done was for that individual to have company set up with him owning all shares in the company save for one which would be held by another individual with that one share even capable of being shorn of the rights involved in share ownership. This practice was discussed by legislators and at one point we accepted that a company could be formed by just one shareholder.

The Notion of Corporate Personality

A company is vested with separate juridical personality. This feature, which means that a company is a separate person in its own right, distinct from the members that make it up is not a feature unique to the LLC. Indeed, the partnership *en nom collectif* as is the partnership *en commandite* as well as foundations and a number of authorities set up by law. In the case of a company the idea of separate juridical persons is important for practical considerations that can be more appreciated in a commercial context. The following are the two main consequences of separate juridical personality:

1. A company can sue and be sued in its own name: When a court case is instituted against a company the defendant will be a company and vice versa.
2. Because a company has separate juridical personality it can have rights and assets are its own and those rights and assets will not belong to the members. Equally, when it comes to liabilities and obligations the fact that a company has a separate juridical personality means that it can and will have its own duties that are solely its and not of its shareholders.

Take, for example, a company which has entered into a contract of sale whereby it sold an apartment that belonged to it to a third party and the selling price was €1,000,000 of which €600,000 was paid on the final deed leaving a balance of €400,000 payable one year after the final deed. This means that because it is XYZ Ltd owed the amount and because it is a separate juridical person from its members, in the minds of its shareholders they cannot say that they themselves are owed the amount. It would be wrong for them to think like that because shareholders are owed nothing of the outstanding balance. XYZ Ltd will have its own liabilities and it may not be able to distribute any of the funds as its financial position would not allow it. Furthermore, A would not be able to sue the third party at any stage for the outstanding balance which A feels entitled to. Complications may arise if XYZ Ltd does not claim the

balance for any reason. There A may be able to take some action to effectively force XZY Ltd to make the claim or possibly take a derivative action in place for XYZ Ltd to sue the third party.

The same reasoning would apply the other way round. Imagine that it was the third party who sold the property to XYZ Ltd with the same particulars. In this case the separate juridical personality would serve to protect the shareholders for any outstanding liabilities. It may be that if the third party is not paid that he may make some kind of claim against possibly the shareholders or members if it fits the limited exceptions required for the lifting of the corporate veil.

Limited Liability

Limited liability is possibly the most important feature of the LLC and has been described by various authors in the most effusive language, describing it as the most effective legal invention of the 19th century. When we speak of limited liability the liability of the company itself is not limited. Indeed, the company will be liable to honour its obligations and to pay its debts with all its property, present and future, beyond even the share capital of the company. The liability of a company, like the liability of any other person is to make good for its obligations with all its property present and future. Even if a debt is contracted in 2022 and is payable in 2025, any assets which the company makes in the meantime will also go to affect payment, if necessary, in 2025.

Limited liability refers to the limited liability of the shareholders Article 67 of the Companies Act states that:

> **67.** *A company is formed by means of a capital divided into shares held by its members. The members' liability is limited to the amount, if any, unpaid on the shares respectively held by each of them.*

If a shareholder pays for his shares in full, then he has no longer any liability vis-à-vis his investment in the company. If one pays for one's shares in part, then one is liable only for the remaining balance on that share. This feature distinguishes it from the partnership *en nom collectif* whose partners are jointly and severally unlimitedly liable. The concept of limited liability has been regarded as such a special development in economic theory and practice because until the 19th century no such concept existed and therefore when, especially around that time, huge enterprises started being created in the minds of businessmen, a lot of funding was required to carry out these huge projects. Without limited liability these projects, and therefore economic development, would not have happened because without it somebody who would invest in a venture might invest a small part of his savings, but because there was no limited liability if the business fails creditors would have been able to turn on these small investors for the entirety of the company's liabilities. Therefore, capital was not being easily generated but what limited liability did was to put people's minds at rest that if they invested X amount that amount would be the absolute maximum they could lose as their liability is limited to the amount, if any, remaining unpaid in the company.

It may be seen as unfair to creditors of a company who, in the case of insolvency, might go unpaid for what is rightfully due to them. In principle, this is a fair position to take. In truth, whoever deals with a company knows or should know what he is dealing with and therefore there is always a risk inherently involved with dealing with a company. Under the law, every company is obliged to publish audited financial statements on a yearly basis and a person should be able to determine whether that company is solvent or not and what its prospects

are from a financial point of view. Therefore, anyone dealing with a company could examine its financial position. In reality, it does not happen that people who are going to enter into a transaction with a company check its audited financial accounts. Most people, unless trained, would not be able to properly understand the accounts. Very often people enter into transactions in a company with a risk and it is up to them to mitigate the risk as they deem fit.

Ease of Transfer

i.e., The ease with which shares in a company or the entire company itself can be transferred, as opposed to the difficulty of transferring the business of the company other than true the sale of the entire shareholding in the company. Take, for example, a company owned by a single shareholder with 50,000 ordinary shares of €1 each. This company operates a small hotel in St Julian's and has been modestly successful. The sole shareholder A, also the sole director of the company, wishes to sell the business and retire. X wishes to purchase the hotel business. Usually, if X wishes to buy the hotel business as operated by A the deal would be structured in the following manner: X and A would enter into a share purchase agreement for A to sell the entire shareholding to X for whatever consideration and under some terms and conditions (including warranties, guarantees, a due diligence exercise conducted by X into the company's books, etc.).

However, sometimes the initial idea is not to acquire the shares in the company, but to acquire its assets and liabilities. This change in approach brings with an immense number of difficulties by comparison because if you had to think about what the assets and liabilities are, from the assets side there will be many (e.g., immovable property, furnishings, stocks of linen, debtors, cash, vehicles, licenses, etc.). Liabilities are the company's obligations, mainly bank facilities, creditors, employees, various contracts, etc. If the idea would be not to acquire the shares in the company but to acquire its assets and liabilities these would first need to be identified. The assets will also need to be transferred by their separate contracts or in one umbrella agreement which is not that straightforward either. If one is to transfer one's debtors, it will be done by assignment and each debtor will need to be notified and their consent or acknowledgement is required. Transferring one's liabilities is immensely complicated because in order for there to be an effective transfer that releases the company from these liabilities there would need to be the agreement from those third parties who have the claims for the liabilities.

Topic VII: Separate Juridical Personality

A company has separate juridical personality because the Companies Act provides it with it in article 4(4):

> (4) *A commercial partnership has a legal personality distinct from that of its member or members, and such legal personality shall continue until the name of the commercial partnership is struck off the register, whereupon the commercial partnership shall cease to exist.*

The Companies Act was passed in 1995 but even before them the separate juridical personality of companies had long been recognised because the Commercial Partnerships Ordinance of 1962 had included a similar provision. Even before 1962 the law had indirectly recognised the separate juridical personality and in English law, on which we place a lot of reliance today, the separate juridical personality of companies had been recognised expressly in the 19th century in the case of *Salomon v. Salomon Co. Ltd.* It is not just the company which enjoys separate juridical personality, in other words it is not the only entity or association of persons endowed with juridical personality because even the other two commercial partnerships enjoy this as well as public corporations, foundations, and authorities set up by law. There are other associations of persons that do not have SJP, such as the family unit or civil partnerships, nor even joint ventures (unless incorporated in the form of a company) or trusts.

To that end, why is the notion of SJP such an important feature of companies and why is it dealing with companies that this principle of SJP comes to the fore? The notion of SJP is linked in the case of a company with the principle of the limited liability of shareholders. Where it not for these two principles combined, today, we would not have over 100,000 companies registered in Malta and the company form would not have become the dominant form of doing business for over a century.

Furthermore, what are the attributes, that is to say consequences of, SJP? First, that a company can sue and be sued in its own name, and second that a company is capable of owning rights and assets which will be regarded as its own, and third a company is subject to liabilities and obligations that are its own and not those of its shareholders.

Salomon v. Salomon & Co. Ltd

Decided by the House of Lords in 1897, this case is illustrative of a number of issues. In short, an individual named Salomon was a sole trader and carried own business in his own personal name as a leather merchant and manufacturer. For a number of years, the business was carried on personally in a successful fashion. Salomon then decided in 1892 to incorporate his business, therefore converting the business into a company. At that time this was not a common practice as most would start their business as an LLC. Salomon established a company called Salomon & Co. Ltd. At the time a company could be set up with a minimum of seven shares each owning a minimum of one share and Salomon had the company set up with the minimum requirements by giving his wife and children one share each. Once the company was incorporated the next stage was to transfer the business, he owned personally to the company which he did. The business at the time was valued at £38,782, a very significant sum. The assets would have included stock held by Salomon as well as cash. When assets are transferred one needs to receive a price. The consideration Salomon received for transferring the business was 20,000 shares of £1 each, as well as a debenture of £10,000 (i.e., an acknowledgement of an amount due by the company, usually by way of a loan) which gave the debenture holder a prior claim over the assets of the company in the event of its

insolvency, meaning a debenture is, in a sense, similar to what is given by a general hypothec. The company also held £8,782 in cash that was given to Salomon.

The business continued but after some time until it started deteriorating and the company went insolvent, until the company went into liquidation. The fundamental question that arose was thus: can the liquidator claim from Mr. Salomon any indemnity for the losses that the company had suffered to be able to pay the outstanding creditors of the company? In this case there were no sufficient assets to be able to pay off all the creditors. This issue ended up in court. The first court decided was as follows: Salomon wanted to create the company to be his agent in the running of the business. Therefore, if the company were the agent Salomon would be the principal. It is a principle of law that the principal has to indemnify the agent against any claims that may be made against the agent by the creditors. The court therefore said that Salomon was the principal, and the agent was saddled with claims, therefore Salomon was liable to indemnify the company against those liabilities ordering him to pay.

The Court of Appeal came to the same conclusion that Salomon was liable but along an entirely different route because it decided that the creation of Salomon & Co. Ltd. was a legal fiction and that it went entirely against the intention of the Companies Act. The Court of Appeal also said that for a company to be properly formed the different shareholders have to have an independent mind and will of their own and said that in this case the company was formed by Salomon and six nominees. The Court argued that the Companies Act wanted different individuals to form a company together and therefore there was no validity and Salomon was liable to pay the debts.

The House of Lords reversed and rejected both previous judgements with a simple analysis: it said that the formalities required for the formation of a company were clear and all that was required was for an M&A to be drawn up and for the company to be constituted by a minimum of seven shareholders each owning a minimum of one share. The House of Lords argued that this is exactly what Salomon did and that the law did not require that the various members of the company exercise an independent mind and will of their own or that they were independent of each other. The formalities were complied with and therefore the company was validly formed. There is then an important paragraph delivered by Lord McNaughton who argued that the company is at law a different person altogether from its shareholders, confirmed the separate juridical personality of companies. He continued to say that even if the business is entirely the same after incorporation as it was in the hands of the sole trader, and even if the same individuals act as managers of the business pre- and post-incorporation, and even if the same people ultimately receive the same profits of the business, the company continues to be a separate persona and there can be no liability on the individuals that had incorporated the company other than as set out in the law. The point made here is that one can see the business before it was incorporated and after and that there will be a very small noticeable difference but notwithstanding the company will be a separate person. He also made one important point about the first court judgement: the company once formed is not the agent of the shareholders, on the contrary, the company can use and often uses the services of the shareholder as its agent. The company was the person carrying out the business and if the original shareholders acted as its managing director, then really it was Salomon personally acting as the company's agent, which company was the principal in transaction. The board of directors today acts as an agent in the name and on behalf of companies.

This judgement created quite a fuss at the time and some law journals had criticised the judgement by saying it was then easy for a sole trader to incorporate a business with six dummies. The judgement stayed and continued to be recognised and was never challenged, continuing for some time to be challenged by authors instead, even being called a *"calamitous*

decision". The criticism went no further, and the law stood as is thus far. However, Dower, the main author on modern company law, stated that this judgement opened up new vistas in the corporate world, mentioning two such new vistas: first, the judgement finally made it clear that the setting up of what was effectively an SME was lawful and it is true that the judgement of the House of Lords settled some debate that had been going on in the previous two decades; second, that Salomon v. Salomon & Co. Ltd made it clear that it was also possible for an individual investing as a shareholder in a company to protect his investment in the company further by taking up debentures in the company in addition to some shareholding that he takes. This is a significant comment for Dower to make for the following reason: when a company is set up it would hopefully continue to generate profits and pay all its creditors and liabilities as and when payment becomes due. Unfortunately, some companies fail and when they do technically, they become insolvent, and the company would not be able to honour all its liabilities. Insolvency involves more liabilities than there are assets available. Imagine first a solvent company that nevertheless goes into liquidation. A liquidator is appointed who tallies the company's assets and liabilities, finding that there is €200,000 worth of assets and €80,000 worth of liabilities, leaving a net asset position of €120,000. The liquidator has only to pay off the remaining creditors and distribute the excess to the shareholders on a pro rata basis to the shareholders.

On the other hand, take, for example, a company gone into liquidation with €200,000 in liabilities and €100,000 in assets. The liquidator must determine how he will split the €100,000 amongst the various creditors of the company. In this scenario the shareholders will clearly receive nothing because they only receive what is due to them if there is a surplus of assets over liabilities.

Alternatively, imagine that shareholders A and B had invested in the company 10,000 shares each of €1 each. This does not change the position of the second company. Whatever shareholding, they put would result in nothing if there is a net deficit of assets. However, imagine that A and B loaned to the company the amount of €20,000 each and that when the company goes bankrupt those loans remain outstanding in favour of the shareholders. The question is: on the insolvency of the company do they have claim at least for those loans made? The answer is yes because they are regarded as creditors of the company. If the company's liabilities are totalled at €200,000, that figure includes the €40,000 owed to the shareholders by way of loan. Therefore, when the liquidator sees which assets and liabilities remain, if there are no causes of preference then that €100,000 would need to be split amongst the creditors of the company pro rate to their claim against the company which really means that, in this case, each creditor will receive half of what is due to him. Therefore, each shareholder would be entitled to make a claim as a creditor of the company and receive half of what is due to him as a creditor. In truth, each of the shareholders would receive their shareholding back.

The situation, in a sense, gets even better for the shareholders and worse for the creditors. Take, for example, a company whose shareholders invested €10,000 each by way of share capital and an additional €20,000 each by way of a loan secured by a general hypothec, giving them a prior ranking claim for the amount covered by the security. As long as the hypothec was validly registered, when the liquidator comes to determine how to split the €100,000 of assets, he will have to take into account preferential creditors. The liquidator will then come to the conclusion that out of the €100,000 worth of assets that the company has he will first have to pay the original shareholders the full amount of €40,000 by way of a repayment of the loan secured by the general hypothec. The remaining €60,000 worth of assets will be divided on a pro rata basis amongst the remaining creditors.

Contrary to the argument that this situation is an unfair one, there are a few points to be made:

1. Persons dealing with companies will know that they are doing so, and they will therefore know that the liabilities of the shareholders are limited, and they have the opportunity to obtain guarantees and make their own inquiries into the company's financial health,
2. The whole concept of limited liability with the unwanted consequences it brings has one huge advantage, that is has enabled huge projects and businesses to be put into place, all of which have helped the economy over a century and a half to grow to an unbelievable extent.

Macaura v. Northern Assurance Co. Ltd.

N.B. In insurance, there is the fundamental concept of insurable interest which means that a person cannot take out an insurance policy unless he has an insurable interest in the subject matter being insured against. This principle applies to both life insurance and also property insurance policies. As an example, imagine one who owns a house and can insure it and its contents because one has an insurable interest therein. However, one will not be able to insure a house and/or its contents if that house and all its contents is owned by someone with whom one has no connection whatsoever. Incidentally, it does not necessarily require ownership over property to have an insurable property. One could, for example, be holding property by way of a deposit or as a lessee and still have an insurable interest.

The facts of this case are as follows: Mr Macaura owned a timber estate in the United Kingdom which belonged to him personally. He then decided to incorporate his business. Incidentally, the House of Lords judgement in this case was delivered in 1925, roughly a century after the decision in Salomon. Macaura established Irish Canadian Sawmills Ltd. and he transferred the business, specifically the timber, to this company whilst retaining the ownership of the land on which the timber was. In return, he received 42,000 shares of £1 each, making him the sole shareholder. Macaura also had some transactions with the company such that he was also a creditor of the company in the amount of £19,000. He was not only virtually the sole shareholder, but also virtually the sole creditor of the company. Macaura insured the timber in his own name, i.e., the insurance policy declared Macaura to be the policy holder. Sometime later a fire broke out and the timber was destroyed. Macaura claimed payment under the insurance policy for the loss of the timber. However, the insurance company refused to pay, claiming that Macaura had no insurable interest in the timber that was supposedly insured and covered.

The matter ended up before the House of Lords which took a harsh, limited stance on separate juridical liability. It stated that there is no doubt that Macaura did not own the timber as he had transferred the ownership to the company, a separate juridical person. On the question of insurable interest, the Court examined whether Macaura, although not the owner of the timber, had still some kind of insurable interest therein. The House of Lords stated that he did not, also stated that Macaura personally did not owe any obligations towards the company as far as the timber was concerned. He was not, for example, a lessee or a bailee of the timber. The Court also addressed the question that was virtually its sole shareholder and virtually its only creditor, stating that Macaura did not have an insurable interest as a shareholder or as a creditor in the company as far as the timber was concerned. The Court also commented that when the fire destroyed the timber the damage caused to Macaura was not because he lost the timber that was insured, but because he lost the value of his shares in the company, but Macaura had not insured his shares in the company against any deterioration thereof. The House of Lords found that Macaura had no insurable interest in the timber and rejected his claim.

Lee v. Lee 's Air Farming Ltd

This was a judgement of the Privy Council on appeal of the New Zealand Court of Appeal delivered in the 1970s. Here, an individual, Lee, had incorporated a company that belonged entirely to him with the purpose of carrying out air farming services, i.e., using a plane to spray crops with pesticides and whatnot. Lee was its managing director in charge of operations and its chief pilot. Unfortunately, Lee, during the course of his work, crashed the plane and died. Mrs Lee made a claim in New Zealand under the then workers' compensation legislation and she would have been entitled to make such a claim if Mr Lee qualified as an employee with the company. The question was this: was Mr Lee an employee of the company, i.e., a workman for the purposes of this legislation? The New Zealand took an approach which was reversed by the PC.

The New Zealand Court of Appeal said that it is true that in company law it is possible for a director to be in a contract of service with a company because he is an individual separate from the company. However, it also said that this situation is different, stating that he could not have legally been an employee because Mr Lee was also the managing director of the company. The NZCA struggled to explain how the same individual could be both at the same time the managing director and an employee of the company, because if it were to be allowed it would be that the same person is ordering himself. This contradiction led the NZCA to reject the premise that Mr Lee was an employee.

The matter went to London and the PC took a clinical approach. To begin with it said that Mr Lee was engaging in the skilful task of piloting a plane, that the internal records show that he was receiving wages for that particular function, and it confirmed what the NZCA that it is possible for a director to enter into a contract with the company. It then came to address the issue that caused the NZCA to decide that Mr Lee could not be considered a worker. The PC said that there is a very simple explanation at law to justify the dichotomy between the managing director and the employee because when Mr Lee was acting as a managing director he was not acting in his own name, but in the name of the company. The relationship was not between Mr Lee in his own name, but between Mr Lee on behalf of the company interacting with Mr Lee as an employee. He was therefore regarded as an employee of the company. To determine who is entering into a transaction it must be seen who the person entering in the transaction is representing or whether he is doing so in his own name.

Dr Anthony Farrugia noe v. Verme Carbone et (COA, 2001)

The plaintiff in this case represented a local bank which had extended a loan to a company which was not repaid, leading to the bank instituting proceedings to obtain a court judgement condemning the company to pay the loan. The defendants argued that the company was owned by minors who are therefore not allowed to enter into contracts, ergo the company was not entitled to enter into a contract. The Court of Appeal rejected this outright on the basis that the company is a separate juridical person and that it is the company entering into the transaction. It is the capacity of the company independently of the capacity of its shareholders which must be looked into. This clearly illustrates the separation between the company and its members. Note that once a company is formed there is a presumption that the company is lawfully incorporated.

Falla v. Sorotos (COA,1976)

This case concerned a company called Malta Aquatic Sports Co. Ltd. The plaintiff was a shareholder, and the defendant was a director. What the plaintiff alleged was that he as a shareholder had suffered damages because of irresponsible conduct on the part of the director Sorotos. The defendant raised this following defence: as a director he owed his duties to the company and therefore the plaintiff was not entitled to sue Sorotos because the proper plaintiff

ought to have been the company. The Court of Appeal came to the conclusion that this is true and if a shareholder is claiming that a director breached his duties that were effectively duties vis-à-vis the company and the damage would have been caused to the company meaning it is the company which should introduce proceedings.

However, the Court of Appeal also said that what the plaintiff was alleging was some direct damage caused by the director to himself rather than the company, so it sent the case back to the first court for this matter to be looked into. The importance of the judgement is the recognition that a Maltese company is a separate juridical person and that directors owe their duties to the company.

Adelina Fenech v. Stiridjone Mizzi

This case had to do with letting and subletting. Note that the basic principle is that unless otherwise agreed in a lease agreement a lessee cannot sublet or assign the lease. If a tenant sublets or assigns the lease, he would have breached the tenancy agreement. The question that arises is what if the agreement was entered into by the landlord and the tenant and that individual transfers the tenancy or sublets it to a company that is wholly owned by him, because the new subtenant would be the outer ego of the original tenant, would there still be a breach of this principle? The answer would be yes and that is effectively what the judgement concluded.

Topic VIII: The Notion of the Lifting of the Corporate Veil

This indicates the exceptions to the principle of separate personality. One of the consequences of separate juridical personality is that because a company is a separate juridical person in its own right it is the company which has rights and obligations, which are its rights and not those of its shareholders. Equally, the principle of separate juridical personality means that officers of the company, like and in particular the directors, are not liable in principle for the debts and obligations of the company because it is the company alone that is liable for its debts and obligations. This principle, which had been established at least since the judgement in Salomon and Salomon & Co. Ltd. has largely remained a fundamental principle of English and Maltese law. in fact, this principle was statutorily recognised in Maltese law first by the Commercial Partnerships Ordinance 1962, and later by the Companies Act 1995. Although the principle remains *"pretty opaque and impassable"*, there are a few exceptions categorised under two main headings: either statutory exceptions, or judicial exceptions.

The question is what happens when there is such an exception to this principle. there are two possible consequences, one of which is more important thana the other, i.e., when the corporate veil is lifted some kind of liability is imposed on the shareholders and/or on the directors personally, and another consequence is that in the context of a group of companies the individual juridical personality of the separate companies is to some extent ignored in favour of some general personality of the group of companies itself. One other important point to note is that the principle of separate juridical personality does not mean, and never has meant, that the internal affairs of the company are entirely hidden from view, such that separate juridical personality still means, for example, that any third party can know who the shareholders of the company are (even if beneficial shareholders hold their shares through nominees), it will always be possible to know who the directors of the company are (it is these who take decisions on behalf of the company and represent it) by conducting a search on the website of the Malta Business Registry, the capital structure of the company (this could be important because it is one thing is a company is properly capitalised with a high share capital and another if it has a low one, although it could be very high and yet the company is insolvent, and vice versa), the audited financial statements of the company (thereby, at least in principle, a third party dealing with a company should be able to know its financial position and whether, for example, he or she should extend credit to this company, although a company may be in delay in the publication of its accounts), who the company secretary is, and who the legal representation of the company is vested in. These are not exceptions to the corporate veil but what the law requires for disclosure.

Statutory Exceptions

A company is formed on a particular day when the incorporation documents are registered by the MBR. Very often, a company continues in existence for years because a company, once formed, will have an indefinite existence, unless the Memorandum of Association establishes a timeframe for its existence. However, there is the notion of the dissolution of a company and there are certain scenarios where a company could go into liquidation or could be dissolved. The law, in article 214 of the Companies Act, sets out a number of situations where a company would be dissolved and entered into liquidation. During this process a liquidator is appointed, and the function thereof is to gather all the assets of the company before paying off all liabilities and distributing any remaining assets to the shareholders. If there are more liabilities than assets, then the shareholders naturally receive nothing, and the creditors will not all be paid in full. Another preliminary point is that one of the causes of the liquidation of a company is where the number of members is reduced below two and remains so reduced for more than six months, although the dissolution will need to be declared by a judgement of the court which

may give a period of time during which this omission is rectified. This does not apply to a single member company or to a company that has converted into an SME.

The question is what happens if a company continues to carry on business for a period of time before it is dissolved and it continues to carry on business with just one member. Then, there is the risk of personal liability on the sole remaining member, because the law, in article 214, says that where a company continues to carry on business with just one shareholder for a period of more than six months then that sole remaining member who knows that the company is carrying on business with just himself as the sole remaining member, will become liable unlimitedly and jointly and severally with the company for all the obligations of the company undertaken during that period of time after those first six months until the company is dissolved or the matter is rectified by introducing a second shareholder. A sole shareholder in this situation would generally convert the company into an SME to avoid the risk of being personally liable for the company's actions. This is one of those exceptions to the principle of separate juridical personality. It may well be, however, that the court does not order the dissolution of the company because it can give a time within which the situation regarding the one member is still rectified and if within that period of time the matter is indeed rectified by introducing a new shareholder, then the personal liability of the sole member will continue until the said introduction and the company is not dissolved.

This is, however, mostly theoretical because in practice there has not been a single case where the sole remaining member becomes liable for all the obligations of the company. This is because, to begin with, a six month period of grace is allowed, and secondly if that sole remaining member would have complied with his obligation to notify the registrar that he had acquired the shares from the departed member and the MBR would either advise that the company be converted into an SME, for which there would be a six month period, or to introduce a second shareholder.

Another two examples of a statutory inroad involve the personal liability of company directors: first, fraudulent trading; second, wrongful trading (*vide* articles 315 and 316, respectively). Both English and Maltese judgements are relevant as the Maltese sections on both are modelled very closely on English legislation and therefore the local courts would, in interpreting these provisions, look at what English judgements have to say. In brief, fraudulent trading is if, in the course of winding up, it appears that any business of the company has been conducted with intent to defraud creditors of the company or any other person, then the court, upon the application of the official receiver, the creditor, the liquidator, or any contributory, may declare that any person who is party to the fraud become personally and jointly and severally with the company liable, for all or any of the debts and obligations of the company as the court may direct. Incidentally, if this type of wrongdoing takes place, the wrongdoers can also be subject to criminal penalties because fraudulent trading can also constitute a criminal offence.

In Malta, the Price Club Ltd cases applied article 315 to impose personal liabilities on the directors for fraudulent trading, and that the company must already be in liquidation for this provision to be triggered. Another point to be made is that the fraud need not necessarily be directed towards the creditors of the company itself but if any fraudulent activity has taken place the court can order the wrongdoers to be liable for the debts of the company. The beneficiaries of any order made by the court against the wrongdoers to pay need not necessarily be the victims of the fraud itself. Even other creditors who were not directly impacted by the fraud can benefit from an order of the court as the directors will be held liable for all the debts and obligations of the company on a personal level. In the UK, where they had a section very similar to our article 315 as far back as the 1930s but did not have wrongful

trading provisions until the 1980s, they had experienced this difficulty that because fraudulent trading required proof of fraud which was often difficult to prove and there were very few cases that held directors personally liable for fraudulent trading. In the 1980s the law in the UK was changed and they introduced wrongful trading which does not require proof of fraud but of negligence at a gross level or recklessness. In the 1990s the drafters of the Maltese Companies Act introduced for the first time both wrongful and fraudulent trading.

Liability for wrongful trading can arise only if the company is in insolvent liquidation (the creditors of the company cannot all be paid). In that scenario there are two tests, as it were: first, if the directors knew or ought to have known that there was no reasonable prospect that the company could avoid going into liquidation by reason of its insolvency; second, assuming the directors knew or could have known, that the directors can be held liable to contribute to the assets to make good for the liabilities of the company, unless the court is satisfied that the directors took every reasonable step to minimise the potential loss to the creditors of the company. If a director knew or ought to have known that the company was going into insolvent liquidation, he can ensure that there will be no personal liability on his part if he took every reasonable step to minimise the loss to the creditors of the company. If he does not do that, then the court can find that director/s liable for wrongful trading, in which case they will be told to pay an amount into the pool of assets of the company which will go to making good the liability of the creditors.

Judicial Inroads

There are both English and Maltese judgements on this point. In the case of ***Gilford Co. Ltd. v. Horne et*** (English Court of Appeal, 1933) Mr. Horne had been engaged as the managing director of the plaintiff company and, in his contract of employment, he had a clause which stated that if for whatever reason Mr. Horne no longer remained an employee of the plaintiff company, then he was barred from soliciting customers of the said company for which he had worked. Mr. Horne terminated his employment and entered into the car business in his personal name, which in itself was not a breach of the agreement because he was bound not to solicit customers of the plaintiff company. However, he was keen on doing so and spoke with his advisor who told him to set up a company but not to appear as a shareholder or as a director thereof. What Mr. Horne did was to have a company set up called J.M. Horne Co. Ltd. and its directors and shareholders were his wife and one of his employees.

This company took over the business that had hitherto been carried out by Mr. Horne and proceeded to solicit customers from the plaintiff company which applies for an injunction against both Mr. Horne and the company which he had founded. What Mr. Horne would have argued would have been that it was the company doing this business, that he had nothing to do with it, and that in any case it was not a party to the contract of employment Mr. Horne had entered into. One issue raised by Mr. Horne is that the clause prohibiting him from soliciting customers was a clause in restraint of trade and was therefore contrary to public policy and was therefore unenforceable, but while the first court agreed with this point the Court of` Appeal did not, meaning the end result was that it was not considered contrary to public policy. Then, the court went into the question of remedies and both courts came to the same conclusion that yes there was because, they said, it was evident that the company set up by Mr. Horne was merely *"a device in order to circumvent the original obligation that Mr. Horne had taken".* When the courts looked at the evidence before it, they came to the conclusion that effectively the company was running the business carried on by Mr. Horne. The court also said that Mrs. Horne, who appeared as the director, was not involved in the running of the business at all, with the same holding true for the second director. On the contrary, there was evidence to the effect that when clients did business with the company, they were in practice

always dealing with Mr. Horne himself. Therefore, the court granted an injunction in favour of Gilford Co. Ltd. against Horne.

Topic IX: Company Directors

Directors are those people who actually manage and administer the company as opposed to the shareholders who actually own the company. From a legal perspective it is important to keep in mind this distinction. A shareholder can never be personally liable for the debts of a company whilst a director may. No definition of the director exists but the interpretation clause in article 2 of the Companies Act:

> *"director" includes any person occupying the position of director of a company by whatever name he may be called carrying out substantially the same functions in relation to the direction of the company as those carried out by a director.*

What is particularly distinctive in this clause is the fact that even if a person is not a director of a company if he is performing the same functions which a director normally performs then for the purposes of the law that person is a director. We may have someone not listed in the M&A of the company but is effectively running it such that for the purposes of this Act that person is a director. A director is typically a natural person but a company itself could also serve as a director, but it is only possible in the case of a private company. In the case of a public company physical persons are required.

Types of Directors

Executive v. Non-Executive Directors

The former is actually involved in the day-to day running of the company whilst the latter attends board meetings but is only responsible to advise on a particular area. This distinction is not specifically found in the law, but the First Schedule of the Companies Act, in article 69 and 70, makes reference to directors who are vested with non-advisory roles and are involved in the day-to-day running. The Code of Principles of Good Governance of the MSE makes specific mention of non-executive directors and it is recommended that a public company have more such directors. That same Code also defined non-executive directors and states that they should be free from … Even the courts have been willing to draw this distinction.

In ***Police v. Angelo Xuereb, Cecil Busuttil, Joseph Ellul Vincenti, and John Gauci*** in which a person was seriously injured at a place of work and the directors of the company were sued criminally for negligence. The court distinguished between those directors involved in the daily running of the company and those who sat on the board to give advice. If a law imposes a strict liability on directors, such as in the VAT Act, any director of the company is personally liable.

De jure and *de facto* directors

The former is listed in the Memorandum and the latter are not but still perform functions as though they were directors. In the case of ***Re Hydrogen (Corby) Ltd*** the court suggested the following definition for *de facto* directors:

> *"[A] de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a de facto director of a company, it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the*

> *company's affairs or undertook tasks in relation to its business which can properly be performed by a manager below a board level".*

Shadow Directors
A shadow director is behind the scenes, whose name does not appear anywhere, but still exercises control. They are not explicitly recognised but it is a fact that they exist. The UK Companies Act specifically defines these.

Alternate Director
Somebody who is appointed by another director as his proxy to attend and deliberate at directors' meetings instead of the director appointed. To be able to appoint such a director the M&A must specifically allow it. If no mention is made of the right to appoint alternate directors, it cannot be done.

Appointment of Directors
Note that the law has changed since the previous year. The first directors are appointed by having their named mentioned in the Memorandum of the company. Until last year, one could have gone to the company registry, formed a company, and put one's name without informing one first. This is no longer possible. In terms of article 139(1) the director must signify his consent to act as a director. Another problem that still exists, however, is that one uses another's home address as the company's registered address without informing one.

After the first appointment, the right to remove directors and appoint new ones is normally vested in the shareholders of the company. Article 139(3) states:

> (3) *Unless otherwise provided in the memorandum or articles of a company, a director of a company other than the first directors shall be appointed by ordinary resolution of the company in general meeting.*

This is not always the case as it depends on the Articles of Association of the company. There may be instances where, as the result of different classes of shares, a particular class has the right to appoint one or more directors, then the appointment of a such a director is not dependant on a general meeting of the company, but on a meeting of that particular class of shareholder. Article 139(4) states:

> (4) *Where the holders of a particular class of shares have the right to appoint one or more directors, in terms of the memorandum and articles of the company, such appointment shall be made by a member or members holding in the aggregate more than fifty per cent in nominal value of the shares represented and entitled to vote at the meeting of the holders of the shares of that class.*

In larger corporations, such as banks, the directors are still appointed at the AGM of the company but there is a real and proper election for such an appointment. Each shareholder is sent before the meeting a proxy form and a list of persons contesting the election with which to vote and inform one's vote, respectively.

If the directors do not state otherwise, a director is typically appointed from one general meeting to another where they would be eligible for reappointment and if they are not removed

at the said meeting they are reappointed to the board. There are two scenarios, however, where directors are not appointed by the shareholders: first, where a director is appointed by the employees of a company (there may be certain companies who hold elections amongst the employees to represent workers at the board); second, if there is a casual vacancy (if halfway through the term of offence a director is removed, resigns, dies, etc., the remaining directors have a right to appoint a director themselves, *vide* article 140(6)). There are also certain scenarios where we find a share qualification for a director to be appointed to the board. Particularly in family businesses or in cases that one wants to ensure that a director is also a member of the company to keep control within the same group of people, the Articles might be drafted in a manner that required that director to own shares in the company. This is not always the case and depends on the articles drafting. Article 139(2) deals with this requirement. Whenever a new director is appointed the MBR must be informed, and this is done by means of filing a Form K. *Vide* article 146.

The maximum number of directors is free but as for the minimum it is two in a public company and one in a private company. *Vide* articles 137(1)-(2) and 139(1).

The qualifications one requires to be appointed a director

No such requirements exist. However, disqualifications *do* exist. One might come across certain specific legislation that imposes certain qualifications for a person to be appointed a director, and these are exceptions to the rule. For example, if one is to be a director of a bank one must be a fit and proper person and be approved by the MFSA, likewise, if one is to be a director of a trust company one must certain qualifications in trust management. In certain specialised and specific legislation, we do find such requirements, but the general rule is that no particular qualifications are required. In terms of article 139(5) as soon as one is appointed a director one must make a specific declaration.

One would be disqualified to serve as the director of a company in terms of article 142 which states that:

> **142.** (1) *A person shall not be qualified for appointment or to hold office as director of a company or company secretary if:*
> *(a) he is interdicted or incapacitated or is an undischarged bankrupt;*
> *(b) he has been convicted of any of the crimes affecting public trust or of theft or of fraud or of knowingly receiving property obtained by theft or fraud;*
> *(c) he is a minor who has not been emancipated for trade; or*
> *(d) he is subject to a disqualification order under article 320:*
>
> *Provided that a disqualification in terms of paragraph (b) shall remain valid:*
> (i) *in perpetuity, if the punishment for the crime he has been convicted of is of imprisonment for life;*
> (ii) *for a period of fifteen (15) years if the punishment for the crime he has been convicted of is of imprisonment between twenty-five (25) and thirty (30) years;*
> (iii) *for a period of ten (10) years if the punishment for the crime he has been convicted of is of*

imprisonment between ten (10) and twenty-five (25) years;

(iv) *for a period of eight (8) years if the punishment for the crime he has been convicted of is of imprisonment between five (5) and ten (10) years;*

(v) *for a period of five (5) years if the punishment for the crime he has been convicted of is of imprisonment between four (4) and ten (10) years; and*

(vi) *for a period of three (3) years if the punishment for the crime he has been convicted of is of imprisonment for less than four (4) years:*

Provided further that in any case the disqualification period in terms of this proviso shall not be less than the term of imprisonment that the person would have been awarded;

(e) such person is holding such office as a company service provider in terms of the Company Service Providers Act without having obtained the necessary authorisation by the Malta Financial Services Authority to provide such service.

(2) *Notwithstanding the provisions of this Act or of the memorandum and articles of a company relating to the formalities of the appointment of a director or other officer and to his qualification, any irregularity concerning the appointment of a director or other officer of a company raised after the completion of the publication of his appointment shall not be relied upon by the company as against third parties unless the company proves that such parties were aware of the irregularity at the relevant time.*

(3) *Third parties who were not aware of the irregularities referred to in sub-article (2) at the relevant time may rely on that irregularity as against the company.*

(4) *The Registrar may restrict a person from being appointed as director or company secretary of a proposed commercial partnership or an existing company if he is or has been a director or secretary of an existing Maltese company in relation to which he has breached the provisions of this Act for three (3) times within a period of two (2) years, that shall be reckoned from the first breach, and he is still in default as to one or more of such breaches.*

(5) *Any person who feels aggrieved by a restriction from being appointed as director or company secretary in terms of sub-article (4) may bring an application before the court against the Registrar for the removal of such restriction.*

(6) *Apart from the disqualifications for appointment or to hold office of a director of a company under the provisions of this Act, any disqualification that is in force or information relevant for disqualification in another Member State shall be taken into*

> *account and the Registrar may refuse the appointment of a person as a director of a company where, at the time, such person would be disqualified from acting as a director in another Member State.*

If one has been so convicted whether or not the disqualification is permanent depends on the punishment received or that which would have been applicable to the offence committed. The proviso to article 142(1) lists different time periods in respect of which one would be disqualified from acting as a director depending on the length of time that one could have been condemned to as the result of the type of crime committed.

Another disqualification is article 142(1)(e). In the case of ***Saint Publius v. MFSA*** one had a kind of authorisation in the UK and started providing corporate services in Malta until they were stopped by the MFSA.

If a company has appointed a director who, at law, should not have been appointed as the result of such disqualifications, and if that director signs a contract on behalf of the company, article 142(2) states that a company cannot take advantage of such a situation and would remain bound vis-à-vis third parties except in a scenario where the third party knew of that disqualification of that particular director. On the other hand, article 142(3) offers the other side to the preceding article such that if a third-party signs a contract with a company and later learns that the director who signed it should not have been appointed, such a third party can inform the company that it will not be bound by such a contract.

Article 142(4) gives the right to the MBR to refuse somebody to serve as a director of a company. This is given so that if somebody is the director of a company but has breached the provisions of the Companies Act three times within the previous two years, then the MBR is entitled to refuse that person as a director of that company. If one feels aggrieved by such a decision a remedy exists in terms of article 142(5). Article 142(6) states that if there is a disqualification or a reason to be disqualified as a director in any Member State then one will not be appointed a director. *Vide* the case of *Dr Kevin Dingli noe v. Dr Joe Bonnici noe* (the Prokidus case).

Apart from the reasons which make a person ineligible to be a director, we also find the possibility of a disqualification order being issued against a particular person disqualifying him from being a director of the company and this order is requested by the Attorney General or the Official Receiver, or the MBR. An application is made to the courts, and it is done against any person who is found guilty of an offence under the Companies Act so long as the offence is punishable with more than a fine. That person must also have become liable to contribute to the assets of a company or he has become personally liable for the company's debts. *Vide* article 320. A person is ordered to contribute to the assets of a company or liable for the debts thereof as per article 315 and 316, which deal with fraudulent and wrongful trading, respectively.

If a person is already a director of a company and the MBR becomes aware that that person was not eligible to become a director, or that there is some kind of disqualification applicable to the said director, the MBR will inform the company of this fact and the company is bound to remove that person as a director, as per article 142(7). If the company fails to remove the director, the MBR will apply to court for the court to order the removal of the director in question, as per article 142(8) and (9).

Another disqualification for a person to be appointed as a director, such that a person cannot be the sole director of a company and the company secretary unless that company is a private exempt company (*vide* article 211).

Termination of Directorship

First, when the term of office for which one has been appointed expires. The term may result either from the appoint itself, from the M&A, or, in the case of a para-Statal company (i.e., a company the shares of which are owned by the government), upon the end of a legislature such that a new legislature can make the necessary appointments, even if the same Party is re-elected. Another way to stop being a director is by simply resigning. Another way is if the director dies, and directorships are not inherited. Another way is if one is removed by a court order, *vide* the case of ***Nita Gavin v. Donaldson*.** The most common way for a person to stop being a director is if the director is removed by the shareholders of the company. *Vide* article 140 which states that, notwithstanding anything contained in the M&A, a simple majority of shareholders can remove a person from being the director of a company. This is an inalienable right. If the right to appoint their own directors is given to each class of shareholders a simple majority can still remove the directors from either class. This is catered to under article 140(1) which states that directors are appointed and removed by a majority of shareholders, but by a majority of voting rights. Therefore, one must stipulate in the M&A that those shares in a particular class are given a high number of votes whilst those in the lesser classes are only given one vote. This is known as weighted voting.

When one wants to remove a director, he must be given notice of the vote and the discussion that is to be held in order to remove him at a general meeting. This director is entitled to be present and heard at that meeting, most likely to make representations as to why he should not be removed. When one has taken the vote and removed the director, shareholders may either appoint another person as a director at the same meeting, or if the vacancy is left unfilled, the remaining directors may fill it as a casual vacancy.

Topic X: The Powers and Duties of Directors

The key article dealing with this is article 137(3) which states that:

> (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.*

Crucially, directors are omnipotent unless the Companies Act or M&A states otherwise. Short of having this prohibition, the directors can do anything. Take, for example, a company whose only asset is a huge immovable property worth a large amount which directors wish to sell. Unless the M&A or Companies Act state otherwise, then the property can be sold. When one is drafting the M&A if they wish to keep something that the directors are to refer to the shareholders to it must be specified as a listed reserved matter.

The juridical nature of the director is such that the director is a fiduciary of the company and as such has fiduciary duties towards it. *Vide* the case of ***GB Comm v. Dr Nikolai Vella Falzon noe***. The notion of fiduciaries was introduced in Malta in 2004 by the introduction of the concept in article 1124A of the Civil Code. The point arises as to whom the directors owe their duty. If appointed by a shareholder to sit on the board of a company the directors owe their duty solely to the company, not to the shareholders. This is an old concept as per ***Percival v. Wright Chancellery*** (1902). There might be some exceptions to the rule where directors owe their duty to the shareholders, but they are particular instances and the most noteworthy is a situation where a takeover bid exists over the particular company, in which the directors have a duty to get the best possible prices for that shareholder in that takeover bid. *Vide* the case of ***Gething v. Kilner*** (1942). *Vide* the case of ***Charles Sant Fournier v. Philip Attard Montaldo*** (07/11/2001) for a local perspective. If a company is facing financial crisis or the possibility thereof, then directors could also owe a duty to the creditors of the company to ensure that they are not prejudiced by their actions. *Vide* the case of ***Nicholsons v. Permakraft*** (New Zealand, 1985).

The M&A is the first source of the duties of directors, followed by the Companies Act and a myriad of other legislation, such as the Health and Safety Act. The duties are of two types, general and special. The former is dealt with in article 136A. These are overriding duties and whenever one is assessing whether a director has acted properly or not this is the first point of reference. Article 136A (3) is noteworthy as it imposes a duty of care and skill. Here, the legislator is imposing a dual test that is both objective and subjective. Therefore, in order to satisfy the degree of diligence, care, and skill required one must pass two tests. If one accepts to sit on the boarder of a highly technical company where certain knowledge is required, one cannot then claim to lack such knowledge. One must appreciate how high the hurdle is for one to claim that one has exercised the due diligence expected of one. Article 143 imposes a prohibition of a director competing against one's own company. One cannot be a director of two companies directly in competition with one another, but one can be a shareholder of a competing company. One cannot be a partner with unlimited liability in a competing partnership either.

Article 144 makes it unlawful to give loans to directors unless approved by shareholders.

Article 145 imposes the duty of a director to disclose any interest in a contract with company.

Article 147 states that the liability of directors for a breach is joint and several. One can escape this as per article 147(1) and (2). One exonerates oneself from this responsibility depending on when one learns of the breach. Therefore, if one takes steps, one will not be held liable jointly and severally so long as one acts immediately and in writing to express one's dissent. If a director is to commit an illegality one must report it to the authorities to exonerated from responsibility.

The special duties arise from the Companies Act and from a series of other legislations. Professor Muscat divides these into six key areas:

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 board and general meetings,
4. Duties relating to record keeping and financial statements,
5. Duties relating to the liquidation of the company,
6. Miscellaneous duties.

One also finds a number of special legislations imposing a duty on directors, such as the Prevention of Money Laundering Act, the Investment Services Act, the Social Security Act, the Income Tax Act, the VAT Act, the Income Tax Management Act, the Merchant Shipping Act, the Competition Act, the Data Protection Act, the Import Duties Act, the Food and Safety Act, the Occupational Health and Safety Authority Act, and the Prevention of Financial Services Abuse Act. Lastly, *vide* articles 315 and 316.

Topic XI: Protection of Minority Shareholders

The question arises when there is a company where one person is a majority shareholder and the other is a minority shareholder, as to whether the majority shareholder can do what he wants i.e., can he just pass resolutions because he has a majority in the company, and he cannot be stopped? And if he can be stopped, how is the right of the majority shareholder to pass resolutions and the right of the minority shareholder who is seeking to stop the majority shareholder balanced? A company is a bit like a democracy where there is the rule of the majority that prevails over everything. If the rule of the majority does not prevail, there is anarchy. There needs to be a structure whereby if there is a majority, what the majority has voted for will be implemented. We will be seeing how over time and how through other instruments and through legislation, we have some form of counterbalancing taking place between the rule of the majority and the rights of the minority.

When discussing the rights of minority shareholders, the point of departure is the famous court case in the names of **Foss v. Harbottle** – House of Lords (1843) which is also replicated in the famous judgement **Edwards v. Halliwell** (1952), whereby it was established that there are two basic principles:

1. If a wrong is done to the company, it is the company itself that must take legal action in order to protect its interests.
2. Whether the company itself will take action or not depends upon a vote of the majority within the company. The problem here arises that if the majority shareholders are the wrongdoers themselves, they are not going to take a vote within the company to protect the interests of the company, and therefore this provision of Foss v. Harbottle is a problematic provision because it affords no protection to minority shareholders.

The position in Foss v. Harbottle was implemented locally in **Falla v. Sorotos** (1976). The point of departure in the Maltese company law sphere was that we adopted Foss v. Harbottle in the 1970s, with all the shortcomings that it brings about.

The rule in Foss v. Harbottle has a serious shortcoming because if the wrongdoers are in control of the company, then there is no protection whatsoever. Therefore, common law (and it was also followed locally), adopted certain exceptions to the rule vs. Harbottle:

1. The first exception where the Court allowed action to be taken by minority shareholders to stop what the majority shareholders were doing was in cases where wrongdoing committed by the majority shareholders was ultra vires their powers.

2. The second exception is where the action of the majority shareholders infringes a personal right of the minority shareholders.

These personal rights arise from the M&A – if e.g., in the M&A there is written that a particular shareholder has a right to appoint a director, and he is not allowed to appoint a director, the personal rights of that shareholder have been breached.

There is another important instrument utilised in regard to the personal rights of shareholders which may or may not be there. Very often, side by side with the M&A of a company, there is a shareholder's agreement which will be matters discussed and agreed to between the shareholders as to how they are going to regulate the affairs of the company and they want the content of that shareholder's agreement to remain private. The M&A is accessible to everybody in the MBR, whilst the shareholder agreement remains confidential between the parties and third parties will not have access to it. In that shareholder's agreement, like with

very agreement, there are rights and obligations and if the majority within the company breach any of the rights of the minority shareholder as contained in that agreement, then there is a right of action for the minority shareholder and that is why it is an exception to the rule of Foss v. Harbottle.

3. The third exception is if there is fraud on the minority.

This is the most important and was developed by the UK Courts over the years. Fraud on the minority requires two elements:

i. The wrongdoers themselves must be in control of the company; and
ii. The wrongdoers must have performed a fraud on the minority.

In cases where the two elements subsist, the English courts have accepted that the minority shareholder, although he is not vested with the legal/juridical representation of the company, may bring an action for and on behalf of the company. So, although he is a minority shareholder, although he may not be a director, although he is not vested with legal representation, he may still bring an action to defend the interests of the company against the majority shareholders who are performing something that goes against the interests of the company. e.g., Shareholder A owns 80% and Shareholder B owns 20% of the shares of the company. The company has commercial properties. Shareholder A starts leasing out certain properties of the company to another company which belongs to relatives of his at a very low rate. In that scenario, due to the exception to the rule of Foss v. Harbottle, the minority shareholder would have been entitled to bring an action in the name of the company against the majority shareholder. This kind of action is called the **derivative action.**

When a minority shareholder brings a derivative action, he is doing so not in his own name but for and on behalf of the company and the proceeds from the case do not go to the pocket of the minority shareholder, but they go to the pocket of the company. In order for a minority shareholder to bring a derivative action, the action must be brought in a timely manner and the person who proposes the derivative action must not himself be in any way tainted. If he himself is not clean, the Court will not entertain that derivative action.

The Maltese courts have adopted these three exceptions to the rule in Foss v. Harbottle. Until 1995 this was the only way of how a minority shareholder could protect his interests because there were no ad hoc sections in the law that protected minority shareholders, with the exception of 1 article in the CPO – Article 150G – that gave the right to request the Court that a company would be dissolved.

Today there are three different sources where one must look when a right of a minority shareholder is being breached:

1. The M&A

The way the M&A is drafted can afford a lot of protection to a minority shareholder. If the shares are divided into classes and certain particular rights are afforded to the class of shares owned by the minority shareholder, there is already more protection being given than if the share capital was not divided into classes. There may be a clause saying that the class of the minority shareholders has a right to appoint a director. The articles can be drafted in a way whereby the majority shareholders will not be in a position to remove the director appointed by the minority shareholders. The bar can be raised when it comes to extraordinary resolutions. To amend the M&A, an extraordinary resolution is required, and if the bar is raised high enough, the majority shareholders will not be able to amend the memorandum without

the consent of the minority shareholders. The memorandum can also be drafted in a way whereby certain particular transactions necessarily require the adhesion of all shareholders or of a particular benchmark beyond which consent is required in order to perform certain transactions. So, one must be intelligent in the manner in which the M&A is drafted, to entrench in the M&A certain protections for a minority shareholder.

2. Check if there's a shareholders' agreement

The shareholders' agreement is normally drafted to ensure certain protection is given to minority shareholders.

3. The Companies Act

When looking at the law, there is a particular section, **Article 402** of the Companies Act, which is the most important article regarding the protection of minority shareholders. There is then to a lesser degree but also equally effective depending on the circumstances, **Article 214.** Besides these two articles which are the classical articles which provide protection for minority shareholders, there are a number of articles that afford a certain degree of protection:

Article 81 says that one cannot compel a shareholder to contribute more to the share capital of the company. Therefore, there cannot be a situation where two or more people have formed a company between them, they have agreed what the share capital is going to be (the money that will be risked in the venture within the company), and there cannot be a situation where a shareholder is compelled to put more money on the table. One can possibly contract out of Article 81 if he wants to, but he cannot be compelled to do so.

> **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.*

Article 131 imposes an obligation that for every general meeting, a shareholder is to receive due notice fourteen days beforehand. In the M&A a shorter notice period may be agreed to but the right to receive a notice of a general meeting, therefore, to be warned, to prepare yourself and if necessary to take legal action to stop that meeting, is a right given to the shareholder in terms of the Companies Act. This right is a right established by law and a shareholder will have to know beforehand that a general meeting will be held.

This acquires a particular important as far as AGMs are concerned, because in AGMs the financial statements of the previous year are given to the shareholders for approval. Therefore, a shareholder will be given fourteen days to analyse the content of those financial statements, if necessary, he can consult his accountant to advise on how the company is performing, and he is given enough time to prepare himself to ask the necessary questions that need to be asked at the AGM. One must remember that a shareholder has no right to see the trade books of the company – that right is reserved to the directors only. A shareholder has only one window in the year where he is given a glimpse of what the situation within the company is,

and that is the AGM. Therefore, one will appreciate the importance of being given adequate time to prepare for that meeting.

> **131.** *The following provisions shall have effect in so 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.*

Article 129 gives the right to any shareholder/s who own at least 10% of the share capital of the company to request that a general meeting of the company will be convened to discuss any particular matter. The directors have 21 days within which to convene such a meeting. If the directors do not convene such a meeting, the requisitionists (i.e., shareholders who requested the convening of the meeting) have a right to convene the meeting themselves.

This becomes important when looking at the example given above where a shareholder is leasing out property for a low price. In such a case, a minority shareholder having 20% of the shares, therefore having more than 10% and being in a position to use Article 129, can bring for discussion the lease agreements that have been entered into and he proposes a resolution that the lease agreements will be dissolved because they are not in the interest of the company because they are far below the market rate, for example. That will force the majority shareholder to pronounce himself on that issue. He will have to attend the meeting, or the meeting will still be convened if he does not attend. A number of scenarios may arise:

- He does not attend the meeting at all, and one may show the Court that he did not want to attend; or
- He attends the meeting and votes in favour of the motion, so the minority shareholder has won; or
- He votes against the motion and therefore it will be clear in black and white that he is backing those particular lease agreements; or
- He might abstain which shows that he did not take action to protect the interests of the company when he should have done so.

So very often Article 129 is used to force an issue to the fore, so the majority shareholder is put in an uncomfortable situation.

> **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.*

If one does not have 10% of the shares in the company, there is another important article:

Article 132 is a residual right given to the Courts to convene any type of meeting of the company be it a directors' or a shareholders' meeting, and the Court also has the power to order or to waive the quorum requirement for that particular meeting.

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.

PMS v. Jaguar Limited – PMS owned 7% of the shares in a company. The other 93% were owned by the estate of a deceased person. The heir of the deceased person did not come forward to accept the inheritance and therefore Jaguar Limited did not have a director because the director was the 93% shareholder who passed away, and without the possibility of holding meetings, filing returns with the MBR etc. They went about it by filing an application in terms of Article 132 asking the Court to convene a general meeting to appoint a director and asking the Court that the presence of only 7% of the shareholders would constitute a quorum because the articles of the company wanted a higher threshold. This is a clear example of how Article 132 may be utilised.

Article 133 provides that at every notice for the convening of a general meeting, every shareholder must be informed in writing that he has a right to appoint a proxy i.e., he has a right to appoint someone else to represent him and attend and vote at the meeting in his stead. This right of the proxy is a right which is used very often where the subject discussed at that meeting is either too complicated or there needs to be experts instead or the situation is a bit messy so the shareholder would want to ensure that he will be represented by a lawyer or auditor who is more knowledgeable on the issues. This is another right which a minority shareholder may utilise to protect him.

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.*

Article 137 provides that if there is a vacancy in the office of the director, any shareholder can ask the courts to appoint a director to fill up that vacancy.

> (7) *If the number of directors of a company is reduced below two any member of the company may at any time after the lapse of thirty days therefrom, make an application to the court for the court to appoint a director or directors for the company in accordance with its memorandum and this without prejudice to the right of the continuing director to fill any vacancy so created in accordance with the provisions of article 140(6) within the thirty days specified herein or at any time thereafter for as long as a director is not appointed by the court.*

Article 151 is a very important article. If the majority shareholders do not hold AGMs, a consequence of that is that no financial statements will be shown, and no auditor will be appointed. Therefore Article 151 gives the right to ask the Court to appoint an auditor to investigate the affairs of the company.

> (4) *If no auditors are appointed or re-appointed as required by the foregoing sub-articles of this article, the court on an application made by any of the directors or by any member of the company or by the Registrar may appoint a person to fill the vacancy.*

Therefore, there are various articles throughout the Companies Act that give the shareholders various degrees of protection.

The Just and Equitable Remedy – Article 214
Article 214(2)(b)(iii):

> **214.** (2) *In addition to the modes of dissolution referred to in sub-article (1) -*
> (b) *a company shall be dissolved by the court in the following cases -*
> (iii) *the court is of the opinion that there are grounds of sufficient gravity to warrant the dissolution and consequent winding up of the company.*

This remedy was also available in the CPO as Article 150G. So, throughout these sections, there was always a remedy the right to ask for the dissolution of the company. This is a protection for minority shareholders because if you have no other remedy to turn to and things

are of sufficient gravity, a minority shareholder can simply bring an action which brings the house down.

Daniel Cremona v. Joseph Lanfranco – 1975 – this was still at the time interpreting Article 150G. The Court held that this remedy was taken from the UK Companies Act of 1948. It was the equivalent of Article 222(f) of the 1948 UK Companies Act and therefore the Court said that it is perfectly entitled to look at the way the British judgements have interpreted this remedy and that the Courts will therefore resort to British judgements in interpreting this article of the law.

The most important judgement is **Ebrahimi v. Westbourne Galleries Ltd** – House of Lords (1973) – this is a cornerstone judgement on which the rights of minority shareholders is based. Facts: Ebrahimi was partnered with someone else on a 50-50 basis. Ebrahimi had no children, and his partner had a son. They were getting on very well together and at a point in time, Ebrahimi suggested to his partner that since his son has come of age, he should be made a partner and they should give him 10% each. The partner obviously agreed. So Ebrahimi had 40%, his partner had 40% and the son had 20%. As soon as the partner and the son had 60%, they kicked Ebrahimi out of the business. It was a simple majority.

The House of Lords held that although the partner and his son did have the majority in the company, what they did was not just and equitable. Therefore, they allowed the dissolution of Westbourne Galleries. The logic of Ebrahimi is that you have to subject the exercise of legal rights to equitable considerations. If one applies the rules of the Companies Act, the partner and son were entitled to hold the meeting to dismiss a director, but the logic of Ebrahimi is that one must not only respect the letter of the law, but he must also go beyond it and look at the spirit with which the partners had entered into that company to ensure that he is respecting the equitable considerations that there are.

The legislator in Malta has not used the words 'just and equitable' because in 1995 when the Maltese law was being drafted, Malta had not yet introduced any notion of equity. However, if one looks at both Articles 214 and 402, it results that the way the Courts have gone about interpreting them, is by using the notion of equity. There is another place where the notion of equity is used i.e., in the Small Claims Tribunal. In front of the Small Claims Tribunal, the adjudicator has to decide the case according to law and equity.

Judgements where Article 214 was applied:

- **Anthony Ventura v. Dr. Martin Fenech** – 6 July 2011
- **Avukat Dr. Henri Mizzi v. Robert Damkaer Malta Ltd** – 1 November 2012 – this is one of the more important judgements. Here the Court quoted the famous English judgement **Re Yenidje Tobacco Co Ltd**.

In both cases there was a collapse of relations between the parties.

- **Christian Mifsud v. F1 Autotest Limited** – 29 November 2012

Jason John Aquilina v. Antoine Camilleri – 29 May 2014 – the St. Phillips Caterers Ltd Case: "Is-sinjifikat ta` din id-disposizzjoni huwa car. Il-legislatur ihalli diskrezzjoni wiesa` lill-Qorti sabiex tistabilixxi hi jekk fil-fehma taghha jirrizultawx fatti u cirkostanzi "gravi bizzejjed" li jwassluha sabiex taghmel iddikjarazzjoni ta` xoljiment u stralc. Fil-Kap 386 ma hemmx tifsira ta` "ragunijiet gravi". Il-Qorti ghalhekk ma ghandha tiskarta xejn. M`ghandhiex tillimita l-esercizzju tad-diskrezzjoni taghha ghal fatti jew cirkostanzi li jkunu sehhew sad-data tal-

presentata tar-rikors izda ghandha taghti piz ghal kull ma jigri anke wara sa ma tigi biex taghti d-decizjoni taghha. Fil-kaz tal-lum, din il-Qorti sabet illi bejn l-attur u l-konvenut – azzjonisti ndaqs tal-kumpannija konvenuta – tant kien hemm problemi u kwistjonijiet li - in sintesi jingabru fi sfiducja assoluta ta` wiehed fliehor - li wasslu to a point of no return fejn il-kumpannija oggettivament ma setghetx tibqa' topera. Id-dizgwid u t-tmexxija hazina kellhom effett tant negattiv li l-kumpannija ngabet fuq irkoptejha. Il-Qorti ghexet di prima mano l-klima ta` sfiducja kompleta bejn l-attur u l-konvenut anke bil-komportament taghhom waqt il-gbir tal-provi".

Ivan Calleja v. M.I.M.S. Supplies Limited – 16 September 2014 – This dealt with a deadlock situation. The Court relied on what Prof. Muscat said in his book: "A company would usually be in a 'deadlock' situation if it becomes impossible to manage its affairs because the voting power at board and general meetings is divided between two opposing groups. A deadlock situation typically arises where a company has two shareholders who are its only two directors and the shareholders hold an equal number of voting shares. If they disagree on major questions in respect of the management of the company, they may be unable to break the deadlock both at board meeting and at general meeting level. Management and other decisions vital to the company will the cease to be taken".
The Court saw no future for this company and therefore it ordered that it be dissolved.

Marclem Ltd v. X – 30 November 2015 – 441/15 JZM
"Hija l-fehma konsiderata ta` din il-Qorti illi hemm kumpless ta` ragunijiet li huma gravi bizzejjed sabiex is-socjeta` Power Point Limited tigi xjolta u stralcjata. Ir-ragunijiet huma dawn: -
a) Il-waqfien tan-negozju tas-socjeta` se jidhol fis-seba` sena tieghu.
b) Il-post tan-negozju tas-socjeta` huwa maghluq.
c) Ighid hekk Andrew Muscat dwar disappearance of the substratum filpag 1020 ta` "Principles of Maltese Company Law" (MUP – 2007): -
"A company`s substratum is the purpose or group of purposes which it is formed to achieve – in other words, its main objects. If the company has abandoned all its main objects (and not merely some of them) or if in practice it cannot achieve any of them, then its substratum has disappeared …"
d) Socjeta` li ma taghmilx negozju hija entita` bla ruh ghaliex ma tkunx qeghda taqdi l-ghanijiet taghha".

English:
It is the considered view of this Court that there is a complex of reasons that are serious enough for the company Power Point Limited to be dissolved and liquidated. The reasons are these: -
a) The cessation of the company's business will enter its seventh year.
b) The company's place of business is closed.
c) Andrew Muscat says this about disappearance of the substratum in pg. 1020 of "Principles of Maltese Company Law" (MUP - 2007): -
"A company`s substratum is the purpose or group of purposes which it is formed to achieve - in other words, its main objects. If the company has abandoned all its main objects (and not merely some of them) or if in practice it cannot achieve any of them, its substratum has disappeared ..."
d) A company that does not do business is a soulless entity because it is not serving its goals."

The Unfair Prejudice Remedy – Article 402
This used to be Article 459 in the UK Companies Act of 1985, and now with the UK Companies Act of 2006, it is Article 994. This is a remedy that will be found in various Commonwealth

jurisdictions, and as a matter of fact, this Article 402 was modelled by and large on the New Zealand article. The main concerns regarding this article are sub-articles 1, 3 and 6.

Article 402(1) provides the **requirements in order to bring an action:**

> **402.** (1) Any member of a company who complains that the affairs of the company have been or are being or are likely to be conducted in a manner that is, or that any act or omission of the company have been or are or are likely to be, oppressive, unfairly discriminatory against, or unfairly prejudicial, to a member or members or in a manner that is contrary to the interests of the members as a whole, may make an application to the court for an order under this article.

The first thing one must appreciate is that it caters for what happened in the past, what is happening in the present and what might happen in the future. Secondly, Article 402(1) is actually two things merged in one and it caters for two scenarios – it may be divided into these 2 different scenarios:

1. 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/s or in a manner that is contrary to the interest of the members as a whole can make an application to the court for an order under this article. The first scenario deals with the affairs of the company.
2. 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/s or in a manner that is contrary to the interest of the members as a whole can make an application to the Court for an order under this article. This deals with any act or omission.

The common factor between both scenarios is the terms 'oppressive, unfairly discriminatory against or unfairly prejudicial'. Our law does not have a definition of what these 3 terms are exactly, but they are terms that are used all over Commonwealth jurisdictions that have an equivalent remedy – UK, New Zealand etc.

The matter came to the fore in **Cutajar pro et nomine v. SC & Co Ltd** – the Court held that each case has to be treated on its own merits and the aim of the law is so that the Court may intervene in those cases where there is a need to give a remedy due to unfair dealing where it is proven that there were acts or omissions that were not just and were prejudicial or where the affairs of the company are not being conducted correctly ("mhux qed jitmexxew sew").

The person who is going to suffer the unfair prejudice does not necessarily need to be the petitioner himself. It could be the petitioner himself is not going to suffer a particular prejudice, but the company is going to suffer a prejudice. This arose in the important case **George Borg v. Primrose** – 16 January 2012 – George Borg was a minority shareholder in 2 sister companies. The majority shareholders were taking money from one company and shifting it to the other company. Technically, by shifting money from one company to the other, George Borg was still a shareholder of the other company, but the Court held that the first company that was having funds taken out of it was suffering a prejudice.

Another important judgement is **Vella et. v. Vella Brothers Ltd** – 9 March 2007 – it has in it a resume of Article 402, the history of how it was developed by our Courts and a reliance on English judgements as well.

Article 402(6) tells you **who may bring the action:**

> (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.

If one refers to Article 402(1), it starts by reading 'any member of the company'. So, the point of departure is that one must be a shareholder of the company in order to bring an action. Article 406(6) then widens the concept because it gives a definition of who is to be considered as a member.
Is Article 402 reserved for minority shareholders?
Normally it is the minority shareholders who need to resort to Article 402, but this provision is not reserved to minority shareholders – it applies to any shareholder.

The situation arose in the judgement **Caroline Zammit Testaferrata Moroni Viani v. Testaferrata Moroni Viani Holdings Ltd** – 30 August 1999 – it was the major shareholder who utilised Article 402. Plaintiff and her family owned 60% of shares in the company, and her cousin owned 40%, but in order to convene a general meeting of the company, a higher threshold was needed than 60% i.e., both shareholders had to be present. The minority shareholder was refusing to attend the general meetings and therefore the company could not function. The majority shareholder used Article 402 to bring an action to say the way the minority shareholders were acting was against the interests of the company because general meetings were not being convened, and the Court ruled in favour of the majority shareholder.

Before the introduction of the single member company, it was customary to have companies where all the shares would be in the hands of one entity or one person, and then there would be one single share at another person, because there needed to be at least 499 and 1 – there needed to be at least 2 persons. So, there were a lot of companies with a person owning just one share. Can that person bring an action in terms of Article 402? Yes – as long as he is a member, whether with 1 share or with 100 shares, he is still a member. The case came to the fore in **Vella et v. Vella Brothers Ltd.**
Reference is also made to:

- **Dr. Pio Valletta v. Jeno Torocsik** – 7 October 2016
- **Maria Carmela Gregory v. Gregory's Co Ltd** – 14 February 2018

In terms of Article 402, the Registrar of Companies may also bring an action. However, this is very rare.

The Concept of the Second-Tier Shareholder
E.g., a minority shareholder in Company A and Company A has a subsidiary company which is the operating company, Company B. All the trading is being done by Company B because Company A is a holding company. Company B is controlled by Company A, where I am a minority shareholder. The wrongdoing is taking place in the way Company B is carrying out its business, therefore I am a second-tier shareholder in Company B because I hold my beneficial ownership of Company B through Company A. Can I use Article 402 if the wrongdoing is taking place in Company B?

The matter was discussed in **Susanne Busuttil v. Frances Busuttil and Sons Ltd** – 6 May 2013 – the Court held that if you are a shareholder in the holding company and not in the

subsidiary where you are alleging that the wrongdoing is taking place, then you cannot bring an action in terms of Article 402. The Court quoted from **Perit Raymond Vassallo v. Anthony Parlata Trigona**, where it was held that in our law, we do not have the concept of the second-tier shareholder and you necessarily have to be a member in the company in which the wrongdoing is taking place to be able to bring an action.

This idea of being a member in a company has led to another situation – if there is a husband and a wife and the shares are registered in the husband's name, can the wife bring an action herself? There are 2 judgements on this aspect, and it all depends on whether the shares form part of the community of acquests or not.

Jean Karl Soler et v. Raymond Vassallo – Court of Appeal – 3 February 2012 – where the shares were paraphernal to the wife, the Court held the husband has no locus standi.

Daniela Galea Souchet v. Cleland and Souchet – 29 September 2016 – the shares formed part of the community of acquests, and the Court allowed the wife to bring an action in terms of Article 402 even though the shares were registered in her husband's name.

Reference is made to the following judgements:
- **Philomena Ellul v. Charles Ellul**

The parties were spouses, and the husband had the majority shareholding in a company and the wife had a minority shareholding. Marital relations went south, and the husband said he has the majority shareholdings, he will convene a general meeting of the company and use Article 140 of the Companies Act to remove his wife from being a director of the company, and that is what he did. Philomena Ellul went to Court. The FH Civil Court ruled that the husband was right and said Article 140 makes it very clear that a simple majority of the shareholders in a general meeting can remove a director and therefore the husband was acting within his remit. In the Court of Appeal, the Court relied on **Ebrahimi v. Westbourne Galleries,** and it held that when there is such a relationship that gives the rise to a minority shareholder to have a legitimate expectation that he will be involved in the management of the company, then you have a quasi-partnership, and one cannot just exclude a shareholder from the management of that company.

- **Anthony Gatt v. Philip Gatt** – 4 July 2013

These 2 judgements, in addition to **Perit Raymond Vassallo v. Regent Holding Limited** – 31 January 2017, all dwell on this notion of quasi-partnership where the original understanding of the shareholders was that they would be involved in the management of the company and therefore you cannot be excluded from the management of the company simply because the majority wants you out.

In order to prove that there was quasi-partnership, from the evidence of the case you must extract the original understanding of the incorporation of the company was. If there is no idea of quasi-partnership, the fact that someone is a shareholder does not give them an automatic right to be involved in the management of the company.

Reference is made to **421 Limited v. Full Finance Ltd** – 21 December 2012

Article 402(3) provides the remedies available:

(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; 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.*

The Court may make any order it thinks fit:

- Sub-article (a): The Court will appoint a board of directors itself as it has done for example in the **iWorld Group case**.
- Sub-article (b): This happened in the **Vella Brothers case.**
- Sub-article (d): It might order the majority shareholder to buy the shares of the minority shareholder –it will appoint an auditor to value the shares and order the purchase of those shares, as happened in the **Gatt case** – majority shareholder was compelled to buy the shares of the minority shareholder.
- Sub-article (e): *
- Sub-article (f): If you have suffered a financial loss, it can provide for the payment of compensation.
- Sub-article (g): To order the dissolution of the company as happened in **George Borg v. Primrose**.
- *Sub-article (e): This is the equivalent of the derivative action because you can apply to the Court to get authorisation from the Court to bring a court case in the interests of the company.
- Reference is made to **Mark Hogg v. Terra Sala Ltd** – 31 October 2016.

The question is: once you have this provision, do you still have the derivative action side-by-side with Article 402(3)(e)? I.e., if you want to bring an action on behalf of the company, if there is fraud on the minority, can you bring a derivative right away, or do you first need to bring an action in terms of Article 402(3)(e), and once you are successful, then you bring an action for an on behalf of the company? The answer is that Article 402(3)(e) has, at least for now, killed the derivative action.

Reference is made to **Soler v. Vassallo** – 3 February 2012 – it was held Article 402(3)(e) is the Maltese version of the Maltese action.

George Borg v. Primrose – the Court made it clear that Article 402(3)(e) is the Maltese equivalent of the derivative action and therefore once the legislator has regulated by law and given a remedy in terms of the derivative action, it is Article 402(3)(e) which applies and not the common law remedy.

Topic XII: Meetings

The separation of powers that exists within the company between the shareholders who hold equity and the managers of the company, when directors and shareholders are not the same person, leads to various types of meetings being held between them. The meetings of shareholders are general meetings whilst the meetings of directors are board meetings. When one speaks of the general meeting of a company one must distinguish between a general meeting and a class meeting. If the share capital of a company is directed into different classes of shares each class of shareholders will have its own class meeting to determine, for example, who they shall appoint to the board, how they will vote on a particular issue, etc. The general meeting is the meeting whereat all the shareholders of the company come together irrespective of their class. There are two types of general meetings: first, the annual general meetings; second, the extraordinary general meeting. As the wording implies, the AGM is a meeting that is held once a year and any other meeting which is not an AGM is by default considered to be an EGM. An AGM must be held once a year and not more than 15 months should elapse between the holding of one and the next, with the exception of the first AGM which can be held within 18 months from the date of incorporation.

Article 128 of the Companies Act on the convening of an extraordinary general meeting on requisition states:

> **128.** (1) *Every company shall in each year hold a general meeting as its annual general meeting in addition to any other meetings in that year, and shall specify the meeting as such in the notices calling it, and not more than fifteen months shall elapse between the date of one annual general meeting of the company and that of the next:*
>
> *Provided that so long as a company holds its first annual general meeting within eighteen months of its registration it need not hold it in the year of its registration or in the following year.*
>
> (2) *Every general meeting other than an annual general meeting shall be an extraordinary general meeting.*
>
> (3) *If default is made in complying with the provisions of sub-article (1), 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.*

What is transacted at an AGM?

The AGM entails a high degree of importance because a normal shareholder of a company has no right of access to the accounts of the company. If one is a shareholder and has suspicions regarding the way on which the business is run, the only opportunity to look into the internal dealings of the company is at the AGM. To that end, they are allowed to ask questions to directors regarding the goings-on of the company. At the AGM the financial statements of the previous year, as accompanied by directors' and auditors' reports, are presented to shareholders for their approval. The content of these financial statements themselves is very delicate as they offer a summary of the performance of the company in the previous year. These financial statements are prepared by an auditor who is kept at an arm's length from the company itself and must check whether or not the trade books offer a true and fair view of the company at a particular date, and if he is not satisfied that the information is

correct or not satisfactory, he has the opportunity to qualify his report, something which would raise alarm bells in the mind of anyone who reads it.

The first order of business at the AGM is therefore the approval of the financial statements. The way in which a shareholder votes on these statements is of great importance as well. If one votes in favour of these statements, one will no longer be in a position to attack their content at a later date. If one votes against, however, one might be considered a negative person and so it would be more prudent to abstain. The financial statements must be given to the shareholders for their consideration together with the notice of the meeting, such that they would have enough time to analyse their content and, if necessary, consult an advisor. What happens very often, particularly in family companies, is that the expiry date for the filing of the annual return approaches and that they shareholders sign the necessary documents as though the AGM took place without actually holding one. The approved financial statements must then be filed at the MBR and the failure to do so carries with it a fine. If a company fails to do so for multiple years, the Registry will simply strike the company off.

The second order of business is the appointment of the directors for the following financial year. If there is nothing in the agenda of the AGM regarding the appointment of directors, they remain in office and continue unto another term. Normally, however, a vote is taken to confirm the existing directors or to replace one or more of them with any new directors that the shareholders wish to appoint to manage the company. One must keep in mind that it is not always the case that the directors are appointed by all the shareholders at the AGM. There may be situations where the share capital is split into classes such that directors are appointed at those meetings of the respective classes. There may also be cases where directors, particularly in large companies, are appointed by the employees in a company following a fully-fledged election.

The final order of business is the appointment of the auditors for the current financial year, which is another important tool giving a lot of protection to shareholders of a company, particularly those who are not in control and are given the assurance that an auditor is going to be appointed to analyse the trade books of the company to ensure to give a true and fair view of the company's performance.

One can now appreciate what a disadvantage a shareholder is at if an AGM does not take place because there may be vacancy in the directorship which is not filled, no auditors may be appointed, and one loses ones right to introspection in the company. The not holding of an AGM is one of those instances for which a company's directors can be fined, as per article 128(3).

The EGM

Any meeting which is not an AGM is an EGM, as per article 128(2). The EGM normally transacts anything which is not the approval of the financial statements and the appointment of the directors and the auditor. Resolutions passed at an EGM are normally extraordinary resolutions, although not necessarily, and these are resolutions which carry a certain weight, normally being used to amend the M&A of the company, to increase the share capital, to issue a fresh issue of shares, if the company is going to repurchase shares, to redeem preference shares, to be dissolved, etc. The legislator has insisted that an EGM take place for these scenarios and others because a fresh issue of shares can dilute the present shareholding. Both the AGM and the EGM are convened by the directors of the company. It is they who will establish the date, time, and place of the meeting. If they are in control of the company and it is not in their interest to convene a meeting the shareholder is left in a hopeless situation. This is why article 129 gives the right to any shareholders who hold at least 10% of the share capital

of the company with voting rights, to write to the directors (known as a requisition) to request that an EGM of the company be convened. In the request they need to lay down what resolution they are proposing be taken by the company and the directors have 21 days within which to accept the requisition made and set a date for the holding of the meeting. The meeting cannot be held later than three months from the date of the deposit of the requisition, and therefore the directors' hands are forced. If they do not establish a date for the meeting within 21 days the shareholders who made the request can convene the meeting themselves, and, if they do, they cannot do so later than three months from when they requested the meeting. Article 129 states:

> **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.*

The law also caters for those members making the requisition to be reimbursed for any expenses they will incur to convene the meeting from the funds of the company. This article 129 is very useful for the protection of minority shareholders who may want a particular issue to be brought up for discussion by the shareholders and therefore if there is something which the majority shareholders are reluctant to discuss or some matter on which they have taken a stance which is not in the best interests of the company, a discussion and a vote can be forced on the issue.

Article 161, regarding the auditor, states that if a person ceases to be an auditor of a company, he shall deposit at the company's registered office a statement of any circumstances connected with his ceasing to hold office and the statement must be one which he considers must be brought to the attention of the members or creditors of the company. If he considers that there is no such statement to be made, he must make a declaration to that effect. This article is important because if one knows or suspects that there is something wrong with the way in which the company is being run, one can simply send a letter to the auditor asking him to investigate a particular instance or transaction to ensure everything is in order. If the auditor feels uncomfortable to investigate or has found something worth investigating, the auditor is trapped as he cannot simply resign but must make a statement. This statement must be brought to attention of the shareholders of the company and once this is done, then the members will want to discuss and shall convene a meeting themselves. The law also gives the right to a resigning auditor to call a general meeting of the company himself, as per article 160.

General meetings can also be convened by an order of the court. Article 132 gives a residual right to the courts to convene a general meeting and can also be used to convene directors' meetings as well. This is the last resort that one can always turn to, to convene a meeting if one is a director or a shareholder of a company.

To convene the general meeting directors must give shareholders notice as per articles 130 and 131 which provide the default conditions as far as notice is concerned. The minimum period is considered two weeks' notice. However, these provisions are alienable as per the M&A. It is possible for all the shareholders to agree that the notice period should be shortened and waived, but this must be done unanimously. Normally, notice must be given in writing by mail at the registered address of the shareholder, but one might agree to have a different form of giving a notice period subject to the M&A. Attached to a notice of a general meeting must always be a proxy form so that if a shareholder wants to nominate someone else to attend the meeting instead he will have the right to nominate such person, as per article 133. The requirement of the proxy form cannot be done away with in the M&A. The proxy must be in writing and very often the Articles shall contain the required format.

Meetings require a quorum to be held, as laid down in article 131(b). An M&A may depart from the given standard by offering a higher threshold or by protecting a particular class. The Articles of Association also offer a procedure as to what takes place if a quorum is not reached. *Vide* the case of *Caroline Testaferrata Moroni Viani v. Testaferrata Holdings Ltd.*

Votes are often taken by show of hands, but it is also possible to demand a poll, that is to say, that a formal vote be taken. It is not possible to have any clause in the M&A that negates the right to demand a poll, as per article 134.

At the end of the meeting, it must be formally decided whether or not the meeting has been closed or adjourned to a later date if unfinished business remains or if it has taken too long. The company secretary would have to formally minute that the meeting has been closed and at which time this took place. The company secretary must record what took place and what was decided at a company's board meetings in the form of taking minutes. Those who attend a meeting have a duty to ensure that what is recorded in the minutes reflects accurately what took place during the meeting as their probative value is beyond question. The chairman of the company typically chairs both board meetings and general meetings. He may or may not have a casting (i.e., second) vote to be used in the event of a tie. If the Articles do not cater for who is the chairman of the company, any persons who are members at the general meeting or directors at the board meeting may be voted by the others to chair that particular meeting.

Resolutions

Resolutions can be either ordinary (which do not require any particular formality to be taken other than being proposed and voted on) or extraordinary, as regulated by article 135. Before one passes an extraordinary resolution, one must necessarily, together with the notice of the meeting, inform the recipient of the notice that an extraordinary resolution will be proposed, including its exact wording and purpose. Whether the threshold which is required for the passing of an extraordinary resolution differs from a public company to a private company depends on articles 135(b) and 135(3), respectively. In the case of a public company an extraordinary resolution must pass two thresholds: first, that those present for the meetings mut be more than 75% in nominal value of the shares represented and entitled to vote at the meeting; second, at least 51% of all those persons entitled to vote at the meeting approve it. If one does not manage to pass both thresholds another meeting is convened within 30 days and at that meeting there is a slightly reduced threshold, as per article 135(1)(b). In the case of a private company, it must be approved by at least 51% in nominal value of all the shareholders of the company entitled to be present and vote at the meeting. This 51% threshold is very often changed in the M&A and increased. Apart from resolutions passed at a general meeting it is also possible for all shareholders to pass a resolution in writing without the need for a meeting, so long as all are unanimously in agreement.

Board Meetings

Directors' meetings are called board meetings and by and large they are more relaxed than AGMs. In a large number of companies, they do not actually take place with directors managing the company without the need for such meetings. The more the company grows the more important it becomes to have the formality of organising board meetings and actually resolving on matters as to how the company should be run. Apart from the fact that good corporate governance would require the convening and holding board meetings, it becomes problematic for those managing the company if they are challenged on how they were authorised to perform a particular transaction if no board meeting was ever convened with such authorisation. Any director can ask for a board meeting to be convened and the notice period for the convenience of a board meeting and the form of notice are normally not as rigid as those for an AGM and they are left to what is contained in the M&A. The idea is that board meetings involve more urgency than AGMs. Once again, it must be agreed on who the chairman of the board shall be, as per the M&A, as well as whether or not he will have a casting vote (typically he does not). The M&A will also lay down what quorum is required for a board meeting to be validly convened and just like with AGM, shall begin with the approval of the minutes of the previous board meetings, matters to be discussed resulting therefrom, and the business as per the agenda. Typically, CEOs sit in on board meetings and non-executive directors shall also be present.

There is a possibility, just like in the case of AGMs, of appointing an alternate director. This, however, is not an automatic right but must be specifically catered for in the M&A, in absence of which no such right exists. Article 132 also covers meetings of the board and allows directors or shareholders to resort to the court to appoint a board meeting itself. Just as in AGMs, it is perfectly possible for resolutions to be held in writing without holding a board meeting provided that they are duly signed by all directors of the company. In the event of a deadlock, the Articles must be drafted in such a way that the impasse is resolved, as a deadlock is one of the grounds which constitutes a situation of sufficient gravity to dissolve the company. This is usually done by having an independent person as chairman who will be given a casting vote. An alternative plan must be in place if such a chairman cannot be found wherein a mediator is appointed to solve the issues between the two parties. If all else fails court remains a last resort.

Topic XIII: Why Companies Fail

"Failure", as a term, refers to when a company is ultimately dissolved and wound up. Dissolution is when the organs of the company decide that they want to stop the company from continuing to run. Winding up is the process that follows dissolution where a liquidator is appointed to wind up the company's affair for it to ultimately stop operating. After both processes the final process is the striking off of the company from the MBR, at which point it shall no longer enjoy legal personality. Winding up and liquidation refer to the same process. Those factors which lead to the failure of a company can be either microeconomic or macroeconomic. The former refers to those factors which affect one particular company, whilst the latter refer to those factors which will impact a group of companies, such as climate change.

Microeconomic factors:

1. **Wrong partner:** This does not only refer to shareholders, but also directors who ultimately have the decision-making power. The wrong partner can easily lead to the failure of the company because if he is not on board with the others certain decisions may ultimately lead to the failure of the company. Take, for example, the merger of AOL and Time Warner in 2001 which demonstrated a wrong partner leading to the failure of the company. This particular merger is widely noted as one of the largest business failures in history, costing both companies 99 billion dollars. The idea was to merge AOL's online audience with Time Warner's television audience. *Vide* the case of ***Adv. Dr. Jean C. Farrugia noe v. Aqua Oasis Ltd et*** (Nru. Rik. 651/2008).
2. **Lack of capital:** In reality, without money a company cannot survive. A lack of capital can arise because of the inability to attract new investors to one's business. One can attract new investors by either issuing more shares (thus, attracting more shareholders which could lead to problems owing to the introduction of new individuals with rights), taking loans from third parties (who are usually banks), or issuing bonds on the Malta Stock Exchange (which are essentially loans from individuals at an interest rate, term, and amount dictated by the company, although paying back loans can sometimes be difficult which may lead to a company issuing further bonds to pay off the old ones). If none of these work companies may resort to the blowback ratio where shareholders do not take any dividends and fully reinvest profits into the company. A classic example of this is the company Enron which filed for bankruptcy due to lack of capital. Its executives attempted to hide its losses for as long as possible (fraudulently) before filing for bankruptcy in 2001. Enron was formed with the intent of serving as an energy supplier by the merger of Huston Natural Gas and Internorth. Over time the company branched into different money losing services which led to its bankruptcy.
3. **Poor financial management:** Even if investors are interested in a company, here, executives do not keep proper records of its finances and take good decisions. K-Mart filed for bankruptcy twice. On the first instance investors were misled over the company's assets. Poor financial management can also be the result of a company which spends far too much money in a short period of time, known as premature scaling. A classic example of this is Pets.com which failed by trying to grow too quickly, being swept up in the dot com bubble. Another classic example was the Price Club (Rik. Nru. 27/2003/1) case where they attempted to grow quickly but failed.
4. **Leadership failure or poor management:** One can fail not because one cannot raise capital or take good financial decisions, but simply because an executive forgets all other aspects of the company. Take, for example, Sears which failed because it could not care about its employees, ultimately leading to employees in turn leaving *en masse*. Today, a company may also fail for taking into account the environmental aspect of its obligations. Another classic example in Malta is ***Miclis Co. Ltd. v. Kevin Fitzpatrick et*** (Rik. Nru. 5/2018).

5. **Lack of profit:** It is true that poor financial decisions can ultimately lead to a lack of profit that can ultimately lead to failure. Revenue refers to all monies in the company, including expenses and profits, whilst profit is calculated after the expenses incurred are deducted. It is very important for the company to calculate its profits as it is profits that allow for growth. The company Northern Rock filed for bankruptcy after a bank run forced it to default on loan agreements.
6. **Inadequate inventory management:** A good inventory management allows one to supervise one's assets, both movables and immovables. Having a good inventory management in place is easier with a smaller company but trickier with a larger one. Walmart lost 3 billion dollars in 2013 because of poor inventory management as the result of overstocking, etc.
7. **No differentiation:** It is important to have a good product, but it is also important to create a unique product to attract new customers and to survive competitors. Fintech companies were able to create something different and innovative. Other companies also created application to allow for online payments or cryptocurrencies. Creating a new product was also seen largely during the COVID-19 pandemic as supermarkets branched into online retail.
8. **Lack of focus or overexpansion:** Differentiation is important, and a company must reflect the clients' requests, but they must also not lose focus. YouTube, for instance, focusing only on videos. No differentiation and a lack of focus are both tricky. A classic example of failure in relation to these two was Blackberry who did not hear their clients' requests and integrated their keyboard into the touchscreen when it was too late.
9. **Poor location:** People tend to look at an ability to park nearby, for instance. Also important is internet connectivity. Providing Wi-Fi is also an important factor for a business to provide.
10. **Personal use of business funds:** In Malta one can create a single member company where one person acts as the sole shareholder and director of the company, taking all decisions and dividends. However, it is important to differentiate the account one has in the company and one's personal account. Furthermore, this may lead to personal liability.
11. **No succession planning:** It is important for one to think in the future to form a company. Not just anyone can manage a company.
12. **Underestimating one's competitors:** Companies can fail by literally underestimating the strength of their competitors. To counter this they must complete a SWAT analysis. Blockbuster, for example, failed after it underestimated Netflix's strength. The same happened to Blackberry and Kodak which both failed to adjust to the new digital era.

We can see that it is important to employ great leaders with a vision and strategy that considers all parties' interests, including those of employees and creditors. Directors are bound to apply the ESV and CSR principles, the enlightened shareholder value principle, binding directors to consider the interests of shareholders as a whole, and the corporate social responsibility principle, which puts the interests of the environment and other social activities at par with those of the shareholder. The distinction between the two is that CSR is more of a theoretical principle based on promises, whilst the ESV is more practical. The UK Companies Act provides for these principles. Articles 136A and 144 of the Maltese Companies Act refers only to the company's interests.

A good leader must also ensure that decisions are taken according to the available funds of the company, thus protecting the company's financial assets. Good leaders shall also understand the company's needs and principles as well as those of their customers. They must also be able to seek advice when they need it. They can only understand these needs if they understand the competitiveness of their competitors. Finally, good leaders must also plan

for the future. It has been seen that one of the biggest failures of companies is when businesses fail to incorporate new technologies and progressions. A classic example is the Ford Motor Co. who, before 2008, restructured its debts and traced funds in its cash reserves, allowing it to survive the crises. Its competitors GM and Chrysler ran out of money and required taxpayer bailouts.

Macroeconomic factors:

1. **Political factors:** Generated by the government, these often interrupt the business marketplace. Besides legislative interventions, an example is a decision to go to war. Which, besides sanctions, leads to huge macroeconomic affects such as inflation.
2. **Legal factors:** It is important to understand that politics refers to government management, whilst this refers to laws. Take, for example, a law increasing the minimum wage, which would affect the margins of small businesses.
3. **Economic factors:** Governments can introduce new tax laws which ultimately change a company's profitability. Another economic factor is the foreign exchange market which affects a company's ability to change currencies. However, some governments choose their company's foreign exchange rate instead of allowing it to trade on the market.
4. **Social factors:** Governments may introduce new laws to reflect its changing populations. Take, for example, new laws to safeguard pensions, or a sugar tax.
5. **Environmental factors:** Weather and climate changes are unforeseen by companies that can ultimately lead to their failure. This is particularly relevant for agriculture.
6. **Technological factors:** Technology is changing constantly, and companies must remain up to date with them.
7. **Pandemic factors:** International diseases as demonstrated by COVID-19. This also refers to groups of infected persons in specific areas. Article 214 of the Companies Act refers to dissolution during such crises.

These may also result in bankruptcy but are often difficult to predict.