CML2011
COMPANY LAW



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Company Law

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Introduction

Company law has gone through various changes over the past couple of years, with such change being recognised even through the Government's recent declaration promising the reinstatement of the Commercial Court, which was abolished in 1995, transferring all commercial matters to the Civil Court. In 2018, an amendment was introduced to establish the Commercial Section of the Civil Court, handling and dedicating itself to all matters falling under the Companies Act, Shipping Law, Intellectual Property, and similar matters. Recently, we had one member of the Judiciary, Mr Justice Ian Spiteri Bailey, who was set to handle all matters pertaining to commercial law in Malta, alongside Mr Justice Henri Mizzi. The court's judgements provide both academics and students with a world of knowledge. All throughout, we have learned that when a legal problem arises, we start with the law and proceed with jurisprudence and text writers.

Company Law is divided into a cluster of lectures which deal with different aspects of Company Law, with the first being the notion of capital. There is a link between capital and the three forms of commercial partnerships, since all three forms of commercial partnerships share this element of capital. We had argued that the way capital is raised in a Limited Liability Company facilitates business and the manner in which investors perform corporate business. We shall see that nonetheless, there are different forms of capital. For the time being, we shall focus on two principal forms of capital, namely **Loan Capital** as distinct from **Share Capital**.

When we are dealing with a **Limited Liability Company,** the key aspect is that the capital of a company is divided into shares, thus coining the phrase *share capital*. We will learn and understand what rights are vested in shareholders owing to the consequences of owning a share. One would seek to own a share to obtain a part ownership of a company. A share's value is contingent on the success of the subject to the share, yet a more realistic evaluation of the share's value is reflected in the dividend yielded by that share. One might involve

themselves in a company as a vehicle of business owing to the concept of limited liability, in that a shareholder is only risking the amount of money invested in that company. This safety net is made possible only through the separate juridical personality enjoyed by a company, lifted only in cases of abuse and issues related to money laundering and fraud.

Sections 315 and 316 of the Companies Act deal with fraudulent and wrongful trading actions. *Fraus omnia corrumpit* dictates that in cases of fraud, all is invalidated, and is reflected under these sections which deal with wrongful trading. It is not at all instances wherein the corporate veil is lifted - there must be a winding up process, as well as an insolvent winding up in the case of wrongful trading. A misconception is that a company winds up due to its failing. A winding up, however, may also come about by reason of insolvency. Another misconception is that bankruptcy and insolvency are interchangeable, which is incorrect since bankruptcy is used in cases of the natural person, whereas insolvency is used in cases of companies, under Maltese Law. From a reading of the law, it does not appear that the court ex officio may bring an action for wrongful trading. However, recent judgements held that a wrongful trading action may be brought up by the courts even though the company is not itself winding up. Thus, while there are significant benefits in establishing a company, there are also some negative consequences which one must be aware of. A company also abides by a corporate statute, which is composed of the **memorandum of association** and the **articles of association**.

One question which may arise is whether the Companies Act and the M&A of a Company interrelate. The Companies Act provides us with a basic minimum threshold of rights that must be included and provided to shareholders, third parties, and society at large. The M&A may be drafted to go over and beyond these minimum rights, so long as such rights are agreed to by the subscribers of the M&A. We will eventually enter into significant detail as to the clauses in the Memorandum and the Articles which must be included in the Articles of Association. For instance, a name clause indicating the company name, must exist in every M&A. Another important clause is the judicial and legal representation clause, with the first being the person authorised to represent the company in court proceedings, while the latter is

the authorisation by the company to represent itself in legal affairs. If we are requested to give advice on a particular contract, which will be entered into by individuals representing different companies, a due diligence check is to determine whether the person entering into such contract is the rightful representative of his company according to the M&A. There is a complex area of company law which will deal with ultra vires, answering the question on what happens a director of a company, or the company itself, acts beyond its powers.

A key player in the company's structure are its two organs - **the Board of Directors**, and the **Shareholders** acting in the General Meeting. The basic rule is that the board of directors are entrusted with the day-to-day running of the company. From the outside, a wrong impression may arise that they are at complete freedom to perform their tasks as they wish. However, the shareholders have significant residual rights through which they may monitor, supervise, and control the way the board of directors carry out the company's affairs. For instance, the appointment and removal of directors is left within the hands of the shareholders. It is important to note that the directors have the continuous trust of the shareholders. Different classes of shareholders may have different powers of appointment. For instance, Class A shareholders may be able to appoint 2 directors, while Class B shareholders may be only able to appoint 1. Thus, while shareholders do not engage in day-to-day running, they play a crucial role in the company's structure. Shareholders are also able to transfer shares according to the requirements by law and by the M&A. **The idea of flexible capital/share transfer is one of the positive aspects pertaining to the LLC.** Share transfer is a complex issue, since it demands a share evaluation, which may be quite costly, which in turn counters the flexibility of the transfer.

We shall see what and how pre-emption rights are exercised, which are, put simply, an obligation on the shareholder wishing to exit out of their shareholding to turn first to existing shareholders and then to third parties. We shall also discuss the case of abuse, the consequent lifting of the corporate veil, the reason behind a company's failure, and the issue of minority shareholding. **Shareholder rule will always prevail provided that the rights of the**

minority are properly safeguarded. One very important section in this regard is **s.402** of the Companies Act. In Malta, this is one area of law in which judgements stand out, because of the manner in which shares are distributed among shareholders.

Going back to director duties, we will deal with the ultra vires doctrine. We shall see that the companies act provides with the minimum duties that directors must adhere to. As a starting point, any director must be knowledgeable of the minimum rights established by the Companies Act. There are also other pieces of legislation which create several duties which carry significant consequences when not observed, such as criminal actions and administrative sanctioning. The ultra vires doctrine, for the purposes of company law, owes importance to **sections 136 and 136A**, which establish the basic duties of a director. In cases of a breach of these provisions, two scenarios may be anticipated; where the company itself is acting ultra vires, or else when a director is acting ultra vires. We shall also refer to the objects clause in the M&A: in the past, various problems have arisen owing to this clause, which determines what a Company is permitted to do by law.

In the past, the objectives clause was drafted quite narrowly, thus increasing the chance of performing ultra vires activities. Today, objects clauses are drafted very widely. One must note that not **all amendments to the M&A result in the complete substitution of the document.** Today, a principal objective proceeds the subsidiary objectives, and thus it is still possible to perform ultra vires activities, albeit to a lesser extent when compared to the past. A director may enter into a contract with a third party and a problem may arise in the representation clause, with the third party being vulnerable to the contract. Essentially, certain sub-articles to article 137 provide certain presumptions which assist the vulnerable party. For example, the fact that the M&A of each company is accessible online does not create the presumption that the third party was aware of the false representation of a director who was not authorised to enter into such contract.

We have a number of instances of preliminary agreements (konvenji), which are subject to a particular time frame, with certain consequences arising when such time frame lapses. There is the possibility of extension (prokura) when both parties agree. The courts have entered into some detail as to **whether the preliminary agreement remains in force or if it collapses in the case of a director entering into an agreement wh**en he is not authorised to do so.

This authorisation is crucial, for a party is vulnerably being exposed to risks in the case of an erroneous faith being put into a director. We will refer to corporate governance, which refers to director duties which are not simply dedicated to shareholders, but which also take into consideration the rights and duties of society at large. Today, we speak of corporate social responsibility and an ESG (Environmental Sustainable Governance).

A company is a legal entity carrying its own juridical personality. A company must also be named. There are various rules which govern the way that a company is named. Every company must carry a Registration Number, starting with the letter 'C', which is given and issued upon the company's registration with the MBR. Such a registration number is akin to an ID Card, since it serves to identify a Company. Upon the registration of the company with the MBR, the company enters into legal existence. Similarly, once a company ceases to exist, for one reason or another, its name and identification is struck off from the company register.

A Company owes its existence to two principal organs, being

1) **The Shareholders**,

2) **the Board of Directors**.

These organs serve as the key players which shape the functioning and existence of the notion of a company and of company law overall. Many of the provisions found in the Companies Act regulate the matters to do with shareholders and directors alike, including provisions which govern the rights and duties of shareholders and right and duties of directors, as well as the ***interplay*** between the two organs.

Shareholders are often referred to as the ***members of a company***, notwithstanding the technical distinction which distinguishes shareholders from members.

The **General Meeting** is the body of members or the body of shareholders. A general meeting refers to the meeting held between shareholders to decide on Company Matters. A distinction must here be made between the AGM (Annual General Meeting) and the Extraordinary General Meeting. An AGM refers to the meeting of the shareholders that is held on an annual basis with the specific intention to discuss the matters enlisted by an agenda. Usually, an AGM will unfold according to a pre-determined agenda, whereas an EGM will tackle certain specific matters which are often not discussed during the AGM.

Separate Legal Personality

Determining the foundation of how a company exists and functions is the most profound and steady rule of corporate jurisprudence. This principle was fiercely ignited in the **1897 case of *Salomon v. Salomon***, which forms the core of the universal commercial law regime.

Salomon v. Salomon

The case was brought to court in 1897 by creditors of Salomon & Co. Ltd, a shoe manufacturing business owned by **Mr. Aron Salomon**. The company had been incorporated as a **private limited company**, with Mr. Salomon owning the majority of the shares and serving as a director. When the company faced financial difficulties, it was liquidated and the creditors claimed that Mr. Salomon should be personally liable for the company's debts.

The court ruled that**, as a separate legal entity, the company was responsible for its own debts and obligations, and the creditors could not hold Mr. Salomon personally liable**. This decision

established the principle of corporate personality and has since been a foundational precedent in company law, both in the UK and in other common law jurisdictions.

The House of Lords reversed the judgement of both the first Court and the Court of Appeals. They annunciate that Mr Salomon in his personal capacity **was at law, separate and distinct from the company, meaning that he in his personal capacity was not to be held liable for the liabilities of the company.**

What the House of Lords did was that it took a look at the applicable Companies Act which required a minimum of 7 shareholders and did not require that each shareholder have a significant amount of shares. Therefore, we could now envision a scenarios where small corporate entities could use the corporate form to carry out business. The second aspect which emerged was this idea of debentures, the idea that an investor could protect their investment through taking up shares in a LLC, but through debentures, an investor could further protect their investment by enjoying a priority in ranking in the case of insolvency.

However, the case has also been subject to **criticism**, particularly for its potential to be used for fraudulent or unethical purposes. Nonetheless, the principle of corporate personality remains a fundamental aspect of modern company law.

The concept of limited liability was created to enable groups of individuals to pursue an economic purpose as a single unit, without the risk of having liability extends to an individual's personal assets. Consequently, a company can own property, execute contracts, raise debt, and make investments independent of its members. Moreover, companies can sue and be sued in their own name. And finally, the most striking consequence of a separate legal personality, is that **a company can survive death of its members**.

Ultimately, ***Salomon v. Salomon*** also established the principle of having a **corporate veil** between a company bearing its own juridical personality and its shareholders. Thus, in certain structures, shareholders are seen as having ***only limited liability***.

Finally, a company bearing its own SLP **may also represent itself in court** (in order to sue or be sued). **Assets of an SLP company are used only for the aims of the company** in question, and its **liabilities are paid by itself** and NOT from the personal assets of that same company's members/shareholders.

By time, the principle of Separate Juridical Personality was introduced in the statute book, as per Article **4 of the Companies Act**:

4.(1) A commercial partnership may be of the following kinds: (*a*) a partnership *en nom collectif*; or (*b*) a partnership *en commandite* or limited partnership; or

(*c*) a company.

(2) A commercial partnership other than a company may be formed for the exercise of one or more acts of trade.

(3) A company may be formed for any lawful purpose and shall have the status of – (*a*) a public company; or

(*b*) a private company.

(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.

Thus both partnerships *en nom collectif, en commandite*, as well as limited liability companies are all vested with a separate juridical personality. This separate juridical personality is to be isolated from the personal capacity of the shareholders who own such company.

The consequences of having a separate juridical personality are plural:

1. A Company is able to **sue** and **be sued** in its own name;

2. A Company is **capable of owning rights** separate from those rights enjoyed by its shareholders;

3. A Company is **capable of owning assets and liabilities** which are separate from those of its shareholders.

4.Can be subject to **duties and obligations** that are its own

You cannot for instance decide that you will sue 200, 000 each when the company is owed 600,000. The court will immediately throw the case out as though it is those 3 individuals

who stand to gain, the company is a separate person and they have no locus standi in an action.

When does this SJP commence, according to article 4(4)?

In order for a company to be validly incorporated by law there are a number of requisites that must be followed. Mostly notably there is the corporate statute, most importantly the M&A. When the **M&A** and **declaration of beneficial owners**, **the deposit** and **opening of a bank account** are presented to the registry of companies and are deemed to be validly constituted, on the date of registration the company is deemed to have a SJP. This SJP, vested upon registration, will continue to subsist until strike off. The relevance of that precision of strike off is that it means therefore that throughout the liquidation process the company retains its SJP. Notwithstanding the fact that the affairs of the company is being wound up, it retains its SJP.

Macaura v. Northern Assurance Co. ltd. (1925)

Macaura was the controlling shareholder of a particular company, and he proceeded to get fire insurance cover **in his own name**, but with the intention of covering his company with it.

Incidentally, Macaura's company was a **timber company**, and unfortunately, all the timber burnt in a fire. Macaura then made a claim to his insurance company, but the insurance company refused reimbursing him, arguing that the **fire insurance he had acquired was in his own personal name, and NOT in the company's name**.

The House of lords agreed that there was **NO insurance interest to claim**. This greatly highlights the notion of a company having a **separate juridical entity**.

Lee v. Lee's Air Farming Ltd.

Lee was a pilot who owned a plane which sprays pesticides over crops in New Zealand. He had an accident and passed away. His spouse wanted to make use of the grant made available to widows of individuals who lost their lives on their place of work. The question was whether Lee was an employee of this company. The court opined that, in the particular circumstances, it was inapplicable because it was difficult to envisage Mr. lee as a director giving orders to himself since they were one and the same person, so it was considered that he was not an employee, and the widow was not entitled to compensation. **The Privy council reversed this judgment because Mr Lee, who has signed a contract with the company, was separate and distinct from the director of the company because one was a corporate entity (director) and the other an employee in his physical capacity.** Although he had different roles, he was considered an employee of the company and so the company was a separate legal entity, even though it was essentially a one-man entity. It was argued that this judgment paved the way for misusing the corporate veil.

The key issue here is the concept of separate legal personality. SLP means that once a company is legally formed, it becomes its own independent entity, separate from its shareholders, directors, and employees. This separation allows the company to enter into contracts, incur debt, and employ individuals as if it were a distinct person.

Because of SLP, **Lee's company was legally separate from Lee himself**, even though he was its only shareholder. As a result, **Lee could indeed be both the sole shareholder and an employee of his company**. The insurance company's objection was based on a misunderstanding of SLP: they argued that Lee could not be both the owner and an employee, as if he and the company were the same legal entity. However, under SLP, **Lee's status as an employee was valid because, legally, he and the company are separate "persons."**

In this case, the **principle of SLP prevailed**, meaning Lee could maintain both roles in his company despite being the sole shareholder. This **allowed his wife to remain covered under the insurance policy** since he was recognised as a legitimate employee of the company.

Dr. Leslie Grech vs the Registrar of Partnership (1979).

There is a distinction when it comes to SJP depending on whether the company is winding up, where in that instance the company retains its SJP. There is a legal obligation that any company which is in the process of winding up and still has its SJP must indicate clearly on all the company's letterheads that it is in liquidation. On strike off the company ceases to exist and therefore the SJP is lost.

When the principle of Limited liability of companies was devised it was rightly hailed as a landmark in the development of commercial enterprise. By vesting a company with the SJP, business ventures could undertake new commercial activity with greater investor benefit. Why is there greater investor benefit because there is SJP? The company's liability itself cannot be limited. Rather it is the liability of the shareholders, the investor of the company who have their liability limited to any part unpaid, if any, on their shares. A company provides an investor potentially the peace of mind that an investor cannot be held personally liable in case of financial collapse.

Louis Vella v. Gozo Consolidated Building Contractors Ltd.

In this case, Louis Vella, a contractor, filed a claim against Gozo Consolidated Building Contractors Ltd. **for non-payment of construction work** carried out at the Citadel Theatre in Rabat, Gozo. Vella alleged that he completed all the work to the satisfaction of the architect in charge. However, **GCBC Ltd. argued that they had no legal relationship with Vella concerning the project**, as the Citadel Theatre was actually owned by the directors personally and managed by **Castle Hill Ltd**.

The court **affirmed the principle of separate legal personality**, recognising that companies are distinct legal entities separate from their shareholders and directors. However, the court observed that **in this case, the directors blurred the lines between their personal interests**, GCBC Ltd, and Castle Hill Ltd. This caused confusion as to who was legally responsible for the contract with Vella, highlighting that the **corporate veil should not be misused to evade responsibilities**.

The court ruled that GCBC Ltd's directors appeared to use the company's identity interchangeably with their personal dealings and with other entities they controlled, such as Castle Hill Ltd. The court held that this undermined the principle of separate legal personality, suggesting that the corporate structure should not be a shield to avoid contractual obligations.

Ultimately, GCBC Ltd was held liable for the payment to Vella based on evidence that pointed to GCBC Ltd's involvement in contracting Vella's services. The court dismissed GCBC Ltd's argument that Vella's agreement was with the directors personally or with another of their companies.

Although not directly accused of fraud, the directors' **failure to clearly delineate responsibilities between their personal assets and those of GCBC Ltd indicated an implicit disregard for corporate integrity.**

Although we focused on English judgments, there is a plethora of judgements by the Maltese courts that reiterate the fact that SJP is a cornerstone of Maltese Company Law. These statements are usually made when there is an action of the lifting of the corporate veil. 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 trading(section 315) or wrongful trading (section 316)), or **judicial inroads** (such as in the case of an action of fraud).

Another thorny issue is whether there could be an action for the lifting of the corporate veil taken by the court ex officio. The law does not seek to give this discretion to the Maltese courts, but the courts have done this in the case of:

Clifford Cauchi & Maria Cauchi Delia vs Invest BG limited (CA - 30th June 2021).

The significance of this case is that here the CA felt the need to resort to the piercing of the corporate veil ex officio justifying such extraordinary course of action by relying on the principle *fraus omnia corrumpit*. The CA upheld the reasoning of the first court where it was stated that considering the surrounding circumstances the court could not permit defendants to evade their personal liability by hiding behind the veil of incorporation. The justification used by the court was that if this would be permitted it would run counter to *fraus omnia corrumpit*. What the Maltese CA did was that it looked beyond the SJP principle, thereby prohibiting the defendants from taking an undue advantage from their illicit behaviour. We had the lifting of the corporate veil ex officio by the court.

Piercing the Corporate Veil

An **exception to a corporate veil** occurs only when the courts actively pierce said veil to extend the force of the law on the shareholders, for example, in cases of fraud. Therefore, even if the principle begotten by the Salomon case reigns dominant, it can be said that the courts may, whenever they deem it fit, annul the **Salomon Rule**. Ultimately, a corporate veil may be pierced if there is ample suspicion that there is **wrongful trading** from a company's behalf. Moreover, the ***Price Club*** judgement was a landmark case in Maltese law because it was the first time a corporate veil was lifted, and the directors were held personally liable for the liabilities of the company.

In such cases, not **only is the company liable to the creditors**, but persons behind the company – such as **directors** and **shareholders** – can be found personally liable towards creditors. Thus, not only may the directors be held liable, but even **company secretaries** may be held personally responsible if the director is incapable of being held liable. So, before becoming employed as a director or company director, it is imperative that said persons understand the risks and obligations annexed to such positions.

Ultimately, the lifting of a corporate veil happens in **3 main instances**:

1. When a company is formed with the intent to defraud creditors.

Here the company is used to defraud or evade legal obligations. This requisite is a **judicial inroad**, formed through judgements, and thus NOT stipulated in the law. In this scenario, **a company is NOT in its dissolution or winding** up phase but **is running normally**.

Prest v. Petrodel Resources Ltd.

Mr and Mrs Prest were a married couple who fell victim to separation. Within their marriage, the matrimonial regime of a **community of acquests** was active. Upon separation, and thus, the dissolution and dissemination of assets in a community of acquests, **Mr Prest started creating companies and transferred particular assets to said companies**. Thus, **he alleged that such assets belonged to the companies under the guise of an SLP**, and did not form part of the community of acquests. His wife challenged this, alleging that said newfound companies were all a **sham**. The **Court agreed with the wife**, concluding that a **piercing of the corporate veil was to take place**, and that, in truth, the **assets belonged to Mr Prest** – as all his new companies were indeed shams. Thus, **all transferred assets were deemed to form part of the community of acquests**.

Gilford Motor Co. Ltd. v. Horne, 1933

In this case, the **defendant was employed with the plaintiff company**. The defendant decided to leave the plaintiff company in order to form another company. However, by virtue of his previous job with the plaintiff company, he **started soliciting customers of his former employer**, ossia the plaintiff company, to his newfound company.

The plaintiff company sued the defendant, and the **latter argued that it was not actually him in his personal capacity who was soliciting customers** – alleging that it was his newfound company who was carrying out such an act. Thus, he argued that the plaintiff company should have sued his new company, rather than him personally. And this by virtue of the separate legal personality of his company.

However, the court concluded that there must be a lifting of the corporate veil due to the fact that this newly established company was a sham, and that Horne was to be directly responsible for any damages incurred by the plaintiff company.

Digital Interactive Ltd. v. Ilead Solutions Ltd.

Digital Interactive Limited transferred its portal (Di-ve.com) and related obligations to Ilead

Solutions Limited under a private agreement. This agreement required Ilead to assume specific obligations, including a loan guarantee with the Bank of Valletta (the "**Jeremie Loan**") and personal guarantees originally held by Digital Interactive.

Ilead and its directors allegedly failed to fulfill their contractual obligations, including missed payments on the Jeremie Loan and replacement of Digital Interactive's guarantees. Only partial payments were made, and further negotiations with the bank were unsuccessful. Thus, Digital Interactive sought to lift the corporate veil, asserting that Ilead's directors should be held personally liable due to alleged abuses of limited liability protection.

The defendants argued that, as directors, they had no direct contractual relationship with Digital Interactive and thus bore no personal liability. However, the court dismissed this argument, stating that the plaintiff's allegations of abuse provided grounds to proceed with the case against the individual directors under the "lifting of the corporate veil" doctrine.

The court referenced ***Nevada Ltd. et v. Hubert Mifsud***, as well as the ***Price Club Case***, indicating that directors can be held responsible if they abuse their company's limited liability status. The court considered that Digital Interactive had sufficiently alleged abuse of limited liability, including possible misleading representations by Ilead's directors that would prevent the company from meeting its contractual obligations.

Ultimately, the court found that while the principle of separate legal personality usually shields directors from personal liability, it would consider piercing the corporate veil if evidence of abuse or bad faith in the company's management emerged.

2. Wrongful Trading (§316, Companies Act).

This action can only occur when a company is undergoing dissolution and winding up, meaning it cannot take place while the company is actively operating. In such cases, **the liquidator may bring action against directors who knew or should have known that creditors would remain unpaid.**

Notably, the Companies Act defines "director" broadly, encompassing anyone who acts in the capacity of a director, regardless of formal title. This type of **action is also easier to prove than fraudulent trading, which requires evidence of intent to defraud.**

316. (1) The provisions of this article shall apply where a **company has been dissolved and is insolvent and it appears that a person who was a director of the company knew, or ought to have known prior to the dissolution of the company that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency**.

(2) The court, on the application of the liquidator of a company to which this article applies, **may declare the person who was a director referred to in sub-article (1) liable to make a payment towards the company's assets as the court thinks fit**.

(3) The court shall not grant an application under this article if it is satisfied that the person who was a director knew that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency and accordingly took every step he ought to have taken with a view to minimising the potential loss to the company's creditors.

(4) For the purposes of sub-articles (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take, are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both -

• (*a*) the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and

• (*b*) the knowledge, skill and experience that the director has.

(5) For the purposes of this article, "director" includes a person in accordance with whose directions or instructions the directors of the company are accustomed to act.

3. Fraudulent Trading (§315, Companies Act)

This action **can only arise when the company is in the process of dissolution and winding up**, meaning it cannot be initiated while the company is actively operating. This limitation is **why the judicial inroads mentioned earlier was necessary**—to prevent unchecked conduct during the company's active life.

The action can be filed not only by the liquidator but also by the official receiver, creditors, and contributories of the company. It may target not only directors but, under the law, any person who intended to defraud creditors. This means it can be brought against shareholders, company secretaries, accountants, and anyone else with such intent.

In the ***Price Club*** case – which was the first ever Maltese judgement to unearth fraudulent trading – the **liquidator filed against three shareholders for both wrongful and fraudulent trading**. The court held that a finding of fraudulent trading implies guilt in wrongful trading, but not the other way around.

Moreover, it is important to note that every fraudulent trading involved wrongful trading, but not every wrongful trading connotes fraudulent trading.

NOTE: For the exam, know the difference in liability between a limited liability company, and a partnership enjoying a separate legal personality (en commandite or en nom collectif).

The Price Club Judgement

Andrew Borg Cardona as liquidator of Price club Operators Ltd v. Victor Zammit et

The Court of Appeal held that a director could not avoid responsibility on the pretext that he did not appreciate the true situation of the company or that he relied on the advice of others. It was not excusable for a director to plead that he was a 'non- executive director' and/or a minority shareholder. A **director shared equal responsibility with other co-directors and**

was under an obligation to know and to carry out his duties, which were imposed by law.

The liquidator of Priceclub Operators Ltd (PCO) filed legal proceedings against ex- directors of PCO: Mr Zammit, Mr Gauci and Mr Fino – for **wrongful** and/or **fraudulent trading** under our Companies Act. Priceclub operated 8 supermarkets and stopped trading in 2001.

The issue was whether the ex-directors should be held personally and unlimitedly responsible for all PCO's debts *in solidum*. To this, **§315 of the Companies Act** becomes relevant.

315. If in the course of a winding up of a company, whether by the court or voluntarily, it appears that any business of the company has been carried on with the **intent to defraud** creditors... the court may, if it thinks proper so to do, declare that any persons **who were knowingly parties to the carrying on of the business in the manner aforesaid be personally responsible, without any limitation of liability for all or any of the debts or other liabilities of the company as the court may direct**.

Moreover, there was wrongful trading under §316 of the Companies Act, which showed that the person who was a director knew, or ought to have known, prior to the dissolution of the company that there was no reasonable prospect that the company would avoid being dissolved due to its insolvency.

It was stated that **PCO's directors should be held responsible for trading when PCO was virtually insolvent**. They chose to commence and continue trading, despite PCO's precarious financial position, to the prejudice of creditors.

From the onset, **PCO was saddled with considerable debts**, Lm2.6 million, and was unable to pay its creditors. It was alleged that **they acted abusively**, with gross incompetence, in breach of their duties and **fraudulently**, to deceive PCO's creditors. Allegedly PCO operated with finance provided by its creditors.

It resulted that:

• Its directors should have known that PCO was insolvent.

• The directors failed to keep proper books of account.

• The **directors did not act honestly with PCO's creditors**. They made false statements, and misled creditors as to PCO's true financial position.

• The directors did not draw up any serious business plan to protect creditors.

In his appeal, Mr Fino argued by saying that the First Court was wrong in its interpretation of the law, in which he also stated that there was no intent to defraud the creditors. However, the Court of Appeal reinforced the First Court's judgement, quoting the principles established by the *1984* ***Grantham Case*** – holding that a finding that a person was knowingly party to the business of a company carried on with **intent to defraud creditors** may be made if the following 2 conditions are satisfied:

1. If that person realised, at the time the debts were incurred, that there was no good reason for thinking that funds would be available to pay the debt in question when it became due or shortly thereafter.

2. There was actual **dishonesty** involving **real moral blame**.

Ultimately (and as fraudulent trading is not actually defined in the laws of Malta), the court had to decide this issue in the light of the circumstances. The court agreed with the conclusion of the First Court. It felt that the directors **acted dishonestly** by continuing trading, to the prejudice of their creditors, **well knowing that the company was insolvent**

and unable to pay its debts. The company was also under-capitalised and burdened by heavy debt.

In this case therefore, the company's financial position was such that the directors should have been aware of the harm to creditors. Creditors should not have been deceived.

Moreover, the piercing of the corporate veil is so effective that even the spouses of the guilty defendants were drawn into the case – as most of the assets of the defendants, which were ultimately used to repay the defrauded creditors, formed part of a **community of acquests** in a marriage.

Wrongful Trading Cases

The Re Produce Marketing Consortium Ltd. Case

This judgment involves the application of §214 of the 1986 Insolvency Act, which deals with wrongful trading by directors of a company.

§214 allows liquidators to hold directors personally liable for wrongful trading if they knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation.

The High Court clarified that the knowledge to be imputed to directors is not confined to what was available in documents at the time. **It also includes knowledge that, through reasonable diligence, directors should have been able to ascertain.**

Justice Knox emphasised that the **directors should have known the company's financial position, even if they did not have access to the accounts**. This imputed knowledge is assessed based on what would have been ascertainable through reasonable diligence.

The judgment focuses on the loss that can be linked directly to the directors' actions, rather than punishing them for the company's financial difficulties. Thus, the punishment was compensatory rather than punitive.

The **directors were found liable because they should have known that insolvency was unavoidable**. The court made it clear that the fact the directors had not seen the accounts did not absolve them of responsibility. They had acquiesced in the delay of the accounts' delivery, and this failure to act or inquire further contributed to the company's financial decline.

The judgment highlights that **directors have a duty to exercise reasonable diligence in understanding the company's financial position**. This is particularly important in the context of a company's solvency and the prospect of avoiding insolvency. Directors are expected to be proactive and should not rely solely on documents immediately available to them. Instead, they should have a general understanding of the company's financial health, as is reasonable for someone with their level of skill and experience.

The judgment also touches upon the principle of separate juridical personality between a company and its directors. The directors' duty to the company does not equate to a personal liability unless they are found to have engaged in wrongful trading, thereby causing depletion of the company's assets

Therefore, even though the company is a separate legal entity, directors are personally liable for wrongful trading when their actions lead to insolvency.

The Brian D Pierson (Contractors) Ltd. Case

This case involves a company that **built and maintained golf courses** but faced financial difficulties due to two uncollected debts from projects. The company went into **insolvent liquidation in January 1996**, and the **liquidator sought a contribution for wrongful trading after June 1994**.

Judge Williamson found that the **company engaged in wrongful trading from June 1994**. However, she acknowledged that external factors, like **bad weather**, contributed to some of the losses. As a result, she **reduced the wrongful trading order by 30%**. She emphasised that **directors cannot be passive** ("**sleeping directors**") and must **actively engage in the**

company's affairs. The absence of advice or warnings from external advisors is not an excuse for wrongful trading.

The defendant argued that **he could not reasonably have foreseen the company's inevitable insolvency**. He pointed to factors such as the nature of the golf course building industry, his reliance on his gut feeling based on years of experience, and the lack of qualified audit opinions for accounts. Additionally, he believed the company's healthy order book and market conditions indicated that the company had a reasonable chance of recovery. He also relied on management figures showing contract work in progress.

The court determined that, in June 1994, a reasonable director in the defendant's position should have recognised the company's lack of prospects for avoiding insolvent liquidation.

The company had consistent cash flow problems and suffered from bad debts. The 1992 audit report's "fundamental uncertainty" warning should have prompted a more careful evaluation of the company's future.

The court also found that Mr. Pierson continued trading as before even in light of unfortunate finances, without taking specific actions to preserve assets or mitigate creditor losses.

Thus, the court ruled that the **defendant's failure to take necessary steps to prevent wrongful trading after June 1994 led to an exhibition of wrongful trading**. The court concluded that despite the defendant's long experience and reliance on his instinct, he should have realised that the company was heading towards insolvency, and he failed to take proper action to prevent it.

Fraudulent Trading Cases

David Buhagiar v. CFS Construction Ltd. et

The plaintiff, David Buhagiar, claimed he had an agreement with CFS Construction Ltd. for the construction and finishing work on his apartment, which was to be completed "at cost." **After paying a substantial amount, Buhagiar argued that he had fully satisfied his obligations**, yet CFS Construction registered a special privilege and legal mortgage on his apartment for additional claimed dues. Buhagiar contested these additional charges, alleging they were inflated and not agreed upon.

Despite the plaintiff's payments, **CFS Construction**, directed by Farrugia, **registered a mortgage on Buhagiar's apartment** to secure payment of an allegedly inflated amount. Buhagiar contended that this mortgage was abusive, unauthorised, and misleading, which led to the loss of potential sales of the apartment. Thus, Buhagiar alleged that the actions taken by CFS Construction, specifically by its director Farrugia, represented a misuse of the corporate structure.

The court reaffirmed that a company is generally a separate legal entity, distinct from its shareholders and directors. However, the court noted that **this protection is NOT absolute**. In cases where there is evidence of **fraud**, **abuse**, or **bad faith**, the court can decide to lift the corporate veil and hold directors personally accountable for their actions.

The court examined whether CFS Construction and its **directors had engaged in abusive practices, specifically by inflating charges and improperly registering a mortgage, to exploit the plaintiff.**

The judgment **emphasised that directors might be held personally liable if they engage in**

fraudulent or deceptive actions while hiding behind the company's corporate structure. In this case, the court found grounds to explore Farrugia's personal liability, as the actions appeared to serve personal interests rather than legitimate company obligations.

The court expressed concern about the mortgage registration by CFS Construction, describing it as potentially made in mala fide without a clear basis in contractual obligations or legitimised proof of work completed. This act, if proven, could signify an abuse of the limited liability that companies enjoy, justifying the lifting of the corporate veil.

Medsea Shipping Agency Ltd. v. Mad Ltd et

The plaintiff, Medsea Shipping Agency Ltd, filed a claim against Mad Ltd (formerly Bluewave Line Ltd), alleging that the company could not meet its debt obligations. The plaintiff sought the company's dissolution and liquidation under Maltese law, citing severe financial mismanagement and **alleged fraudulent actions by its directors**, **Cali** and **Calcaterra**.

The company, initially incorporated in 2008 under the name Bluewave Line Ltd, later changed its name to Mad Ltd, though its registration number remained the same. **Financial mismanagement was evident**, with **no submitted financial statements** or **tax returns** from 2008 onward.

Despite assurances in communications and public statements that the company was performing well, **creditors, including Medsea, were left with unpaid debts**. The company's directors allegedly continued to contract debt while knowing the company had no financial means to settle these obligations.

Cali and Calcaterra allegedly **misused the corporate veil by using the company as a shell without assets or significant property**, effectively exposing creditors like Medsea to substantial risk.

The court emphasised the importance of separate legal personality as a standard principle protecting company directors from personal liability. **However, it noted that this protection could be removed if there was evidence of abuse or fraud that intentionally harmed creditors**.

The court discussed **§315 of the Companies Act**, which **allows the court to hold directors personally liable if they knowingly conducted business with the intent to defraud creditors**. Here, the directors' refusal to meet their obligations, along with the absence of basic corporate governance practices (such as the filing of financial statements), suggested an **abuse of limited liability**.

The court therefore reviewed precedents (including the ***Price Club*** case) and determined that this case demonstrated grounds to consider the directors personally liable for the company's debts under **§315**.

The court's findings also highlighted the **responsibilities of directors to maintain accurate financial records and operate transparently**. This case reinforced that directors could not misuse the corporate structure to evade responsibilities, especially when creditor interests are jeopardised.

Morphites v. Bernasconi

Here, it was decided that if a company defrauds one creditor, it does NOT mean that said company created the whole business to defraud all its creditors. Thus, each case must be analysed and proven on its own merits.

Basic Notions of Company Law

The Corporate Constitution

The **corporate constitution** of a Company refers to the **M&As** of the Company. Technically, the Memorandum and Articles of Association are two separate documents: the **memorandum of association** and the **articles of association**. However, colloquially, we refer to them as the Memorandum and Articles of Association.

The essential differences between the Memorandum of Association and the Articles of Association are essentially twofold;

1) The **Memorandum** is of particular interest to **third parties** entering into relationships with the Company (for a number of reasons, such as the fact that the contents of the Memorandum are matters which a third party to the company should check before contracting with such company, such as contents pertaining to the persons vested with **representation of the company**, the **objects of the company**, etc), while the Articles serve to govern to the **internal management** of the company. Notwithstanding this, the Memorandum is also of particular interest to the shareholders. Furthermore, this does not mean that a third party should not also examine the articles of association, because there may be provisions in the Articles which could be of relevance to a third party dealing with a company (for example, it could be that the Articles contain a provision which states that if the company wants to alienate an immovable property, then shareholders' consent is required).

If a clause like the share capital clause was included in the articles of association instead of the memorandum this would not be accepted by the MBR though on the other hand there are provisions that normally are included in the articles but are instead in a particular case are

included in the memorandum that does not bring about a nullity and the MBR probably would not object.

This does not mean that a third party dealing with a company should not look at the articles as there are situations like when a third party wants to acquire shares from a company where it would be more than wise to look at these articles. These articles can also restrict powers of directors. For example there could be a clause stating that if the immovable property being acquired is above a certain amount then the directors would need prior consent from a GM.

2) The Law sets out what the Memorandum of Association **should contain**, but it does not disclose what the Articles of Association should contain. It does not matter if in the Memorandum of Association there are provisions which are not listed in the law as a requirement to the Memorandum, **provided that those listed entries in the law are also included in the Memorandum.** When it comes to the Articles, there is no particular provision of law which sets out its contents - but rather, **the Companies Act's First Schedule sets out a model Articles of Association**.

Therefore, the original subscribers may state, in their Memorandum of Association, that the Company's management shall be regulated and bound to the **first schedule to the Companies Act**. Another option is to state that the model articles per the first schedule apply, but then that there will be **additional provisions which supplement the model articles in the law.**

One must note that in the case that the Company does not draw up Articles of Association, the First Schedule to the Companies Act applies *ipso jure* to that Company. This is established in **article 75 (2)** of the Companies Act;

75. (1) There may be registered, with the Memorandum, articles of association (hereinafter referred to as "articles") which shall be signed by the subscribers to the memorandum and prescribing regulations for the company.

(2) If **articles are not registered, or, if articles are registered, in so far as the articles do not exclude or modify the regulations contained in the First Schedule, such regulations shall be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles.**

Thus, the Corporate Constitution of a Company under Maltese Law consists of **two documents**. This splitting up into two documents was an innovation introduced by the **Commercial Partnerships Ordinance** and was adopted from English Law. If the original subscribers choose to adopt the model articles of association, the question arises as to what would happen if the legislator chooses to amend the law.

In such a case, one may argue that it is the original model articles which apply, and not the amended ones, since those are the articles which were originally subscribed to. In order to solve this problem before it arises, one may decide to write the Articles using the model as a basis, in order to self-contain the articles. In practice, today, most Companies draft their Memoranda and Articles of Association according to adaptations and practices of drafting which has developed over the past years.

Article 69 of the Companies Act establishes the minimum clauses required in the Memorandum of Association, with the most important being;

1) The **naming clause**, declaring the name of the Company - if the Company is a public company, then the name must end either with the abbreviation ***plc*** or else ***public limited company***, while if the Company is a private company, then the name must end either with ***ltd***

or else with ***limited***. To this end, one may file a Memorandum prematurely in order to **reserve the name of the Company** before it is actually established. This is suggested because by doing so you are avoiding that another company takes the name of your intended company, and also because the Registrar has the discretion to refuse certain names, if for example they go against public policy. The registrar of companies can also refuse a name if it is similar to the name of another company registered

2) The **nature of the company** - whether the Company is private or public;

3) The **registered office** (which must be an address of an actual place **in Malta** and which does not have to necessarily be the office in which the head operations take place) as well as the **email address** of the company (as introduced in 2021). **Except for the registered office clause all the provisions of the memorandum and articles in order to change require an extraordinary resolution of the shareholders. So virtually every clause needs** it. This clause can be changed by the directors without the extraordinary resolution and the address needs to be of a real place in Malta.

4) The **objects clause** - the objects of the company can be **for any lawful purpose** and need not be restricted to the carrying out of acts of trade. There used to be a time where a LLC had to have its objects state that it was created with the object to carry out acts of trade - this is not the case today. Today, one can list an object which states that the Company can carry on acts of trade in general, or rather that the Company can carry out business in general. The reality is that sometimes a Company can have objects which are broadly defined which include objects which effectively mean that the Company can do anything it wants - the law does not restrict the drafting of the objects clause. One may opt to have restrictive objects if the original shareholders, for instance, wanted solely to contract works related to property development, and nothing else. If a Company conducts business which is not contained in the objects clause, it is deemed to be **acting ultra vires**, in which case certain provisions of the law serve to remedy such a situation, as we will discuss later on.

5) The **names and address and number of shares taken up by the Original Subscribers**;

6) The **management clause -** (the number of directors, their addresses, their names, etc);

7) The **representation clause** - who will be entitled to represent the Company on contracts,

returns, etc;

8) The **Company Secretary** clause;

9) OPTIONAL: Duration Clause - most companies do not have this clause, allowing its run time to be perpetual and indefinite until struck off. There was historically a period of time following the enactment of the Commercial Partnerships ordinance in 1962 when a number of companies had a duration clause which read; the company is being set up for a period of 10 years. This type of clause usually would have been supplemented by additional wording, and this period is automatically renewed for another period of 10 years unless an extraordinary resolution is taken before the expiration so that another 10 years do not happen.

10) OPTIONAL : Limitation / Liability Clause - states that the liability of a shareholder is limited to the amount which is left unpaid in relation to shares issued to him - this is optional because this applies independently of whether it is included in the Memorandum or not as it is laid out in the companies act article 67.

In broad terms, the **purpose of the M&As** are; 1) To **identify** the Company and its members, (2) To **set out its objects and capital**, 3) To **determine the manner in which power is divided** between the members and directors, 4) To **establish rules** regulating its internal affairs.

Farrar describes the purpose of the M&As as *to provide for the distribution of profit, risk, and control within the Company*.

The M&As bind the company and its members and can generally be regarded as a **contractual set of documents**. It has been said that the Memorandum governs the relationship between the company and the outside world and informs third parties dealing with the company what are its objects, its sphere of activity and its capital. On the other hand,

the articles regulate the internal affairs of the company and contain regulations for the management of the affairs of the company and the conducting of its business.

Once registered, both the Memorandum and the Articles become **public documents** and are open for inspection by any member of the public. **Prof Cremona** had stated that ***this means that any person, who has dealings with the Company, is affected with notice of all that is contained in them***. This principle needs to be qualified in the case of the Companies Act in relation to limitations on the powers of board of directors or of any director of the company. These qualifications to the general principle relate to the *ultra vires* doctrine, which will be discussed later.

With regards to the contents of the Memorandum of Association, a few general observations are made by **Prof Muscat**;

i) In the first place, the law does not hold any requirement as to the **order of the clauses** – such order is left entirely up to the drafter of the Memorandum;

ii) All the clauses referred to under **article 69** are required ***ad validitatem*** **-** the Registrar will refuse to register a company if any of the clauses are missing or incomplete as regard to the details required by the Companies Act;

iii) Although the Memorandum must contain all of the Article/ Clauses, it **is not contrary to law to insert any other provisions** regulating matters of the Company, provided that **at least** the article 69 clauses are contained.

iv) The purpose of the M&As, as can be seen from the contents required per **article 69**, is to govern *the relationship between the company and the outside world* and to *inform third parties who deal with the company*. Indeed, all the clauses are of concern to third parties who deal with the company.

69. (1) The memorandum of every company shall state:

(a) whether the company is a public company or a private company;

(b) the name and residence of each of the subscribers thereto;

(c) the name of the company;

(d) the registered office in Malta and the electronic mail address of the company;

(e) the objects of the company;

(f) the amount of share capital with which the company proposes to be registered

(hereinafter referred to as "the authorised capital"), the division thereof into shares of a fixed amount, the number of shares taken up by each of the subscribers and the amount paid up in respect of each share and, where the share capital is divided into different classes of shares, the rights attaching to the shares of each class;

(g) the number of the directors, the name and residence of the first directors and, where any of the directors is a body corporate, the name and registered or principal office of

the body corporate, the manner in which the representation of the company is to be exercised, and the name of the first person or persons vested with such representation;

(h) the name and residence of the first company secretary or secretaries, or where a company secretary is a body corporate, the name, registration number and registered office of the body corporate;

(i) the period, if any, fixed for the duration of the company.

These must be contained in **every Memorandum of Association**, independently of whether the company is private or public. However, for **public companies**, as previously mentioned, **further requirements exist**, which requirements are contained under **Article 69 (2)**;

69 (2) In the case of a public company, there shall be annexed to the memorandum a document providing:

(*a*) **the total amount or an estimate of all the costs payable by the company or chargeable to it by reason of its formation up to the time it is authorised to commence business**, and of all the costs relating to transactions leading to such authorisation; and

(*b*) a description of any **special advantage** granted prior to the time the company is authorized **to commence business** to anyone who has taken part in the formation of the company or in transactions leading to such authorisation:

The Representation Clause

One must pay particular attention to the **representation clause** which is contained in the Memorandum of Association. This clause comprises two sections - **legal and judicial representation** and **contractual representation**. A transaction which involves a company as a party to such transaction must be performed following **due diligence** checks. In this respect, due diligence pertains to the ensuring that the party contracting therewith is **authorised to bind and represent the company in terms of the representation clause**.

"*The legal and judicial representation of the Company shall be vested in any one director or in addition, and without prejudice to the aforesaid, the board of directors may, from time to time, appoint any other person or persons to represent the company in a particular case or classes of cases*"

The above is an extract of how a typical representation clause would look like. It appears that the default position adopted by most companies is that both the legal and the judicial representation is vested in the directors. The way this extract is worded is that such directors may appoint certain persons to be vested with representation vis-a-vis **particular but regularly occurring cases**. For instance, the BoD may authorise a person to represent the

company in cases where **vat collection** is concerned, for instance. If the person so authorised acts beyond his authority, he would be acting **ultra vires**.

Contractual and legal representation of a Company are often established by the same clause in the M&A, with one sub-clause dealing with legal representation and another which speaks of contractual representation. There is no requirement by law, however, to split representation in these two components. Thus, a company may vest both legal and contractual representation in the same person and in the same clause. In fact, in **Article 69 of the Companies Act**, the law only requires that the Memorandum establish which directors are vested with the *representation* of the company, without making such distinction.

69 (*g*) the number of the directors, the name and residence of the first directors and, where any of the directors is a body corporate, the name and registered or principal office of the body corporate, the manner in which the representation of the company is to be exercised, and the name of the first person or persons vested with such representation;

Today, the ease with which one may take an action against a company is largely due to important legislative development which has occurred through our law - specifically via the law of procedure. One of the main legislative amendments which have manifested such important changes post-1995 is that of **Article 181A (1) of the COCP**. This provision introduced the rule in the COCP which requires that in the case of a written pleading filed by or against a juridical person, it is sufficient to state the name of such body.

181A.(1) Where a written pleading is filed by or against a body having a distinct legal personality, it shall be sufficient to state the name of such body.

Angela Fenech vs Joseph Felice noe

CoA 1997

In this case, the judicial action was filed against Joseph Felice in the name and on behalf of Tower Limited. Joseph Felice pleaded that he did not have judicial representation of the Company. The Court of First Instance ordered that the written pleadings be amended in the sense that the name of Joseph Felice be struck off, leaving only the name of the Company. **The Court of Appeal remarked that it was irrelevant whether or not the persons vested with judicial representation are mentioned - these are details which the law does not require**. If they are mentioned in the written pleadings, the Court may strike such names out in order to regularise proceedings.

"This plea is nothing more than a legalistic quibble that is entirely unsustainable at law. Article 181A of Chapter 12 clearly provides that *'when a pleading is filed by or against a body having legal personality, it shall be sufficient to state the name of that body'*. **This means that if the name of the company (and this applies to any body) which undoubtedly has a distinct legal personality has been correctly indicated by the plaintiff — and on this there is no dispute — then that company has been properly sued, and nothing further is required**. It is therefore irrelevant whose name is indicated as having the legal representation of that company. Whether that person is correctly indicated, incorrectly indicated, whether they actually had the legal representation of the company on their own, or whether they had such representation jointly with someone else who was not cited — these are details that the law does not require. **This is because, contrary to the position before the amendments, today it is not the person who has the legal representation of the defendant company who is cited to answer the plaintiff's claims, but the company itself, *as a legal person*, in its own name and under its own name alone."**

Another important amendment is **Article 181A (2) of the COCP**, which requires that any sworn pleading must be so sworn by the person with the person who is vested with the judicial representation of the company, or by any company secretary or any other person so authorised.

181A (2) Any d**eclaration or pleading to be sworn in terms of law shall, in the case of a body having a distinct legal personality, be sworn by the person or persons vested with the legal or judicial representation thereof or by any company secretar**y or by any other person authorised in writing by such body to file judicial acts on its behalf or to make any such declaration, sworn reply or sworn pleading.

This is important because **it is essentially vesting the Company Secretary with representation independently of what the representation clause provides**.

Thomas Gehrmann pro et noe vs Maltacom PLC

FHCC, 29th March 2004

In this case, the defendant (Maltacom PLC) requested the court to order a fresh service (notifika) of the summons, as the service made was not a valid one. The defendants were contending that the service of the summons was not valid. The Plaintiff, on the other hand, submitted that the proper procedure was followed. The legal procurator, it was argued, was properly served with the summons, since according to **Article 181A of the COCP**, **he was authorised to file judicial acts on its behalf or to make any such declaration, statement, or pleading.**

Other procedural rules include **article 786A of the COCP** which provides that it is not lawful to raise the plea of incapacity of a party against any of the aforesaid persons.

786A. It shall not be lawful to raise the plea of incapacity of a party against any of the persons mentioned in article 181A(2) in the case of a body having a distinct legal

personality, and in the case of any person mentioned in article 187(7) in the case of a ship or other vessel.

Allcare Insurance Agency Limited vs Mark Randon

Court of Appeal, 6th July 2007

This Court is of the opinion that the resolution of the dispute is found precisely in what is provided in the Memorandum and Articles of Association of the respondent company. It must be stated that this Court does not agree with the appellant that the exception — or rather exceptions, because as we shall see there are in fact two — which the appellant sought to raise before the First Court were of a peremptory nature to which Article 732(1) of Chapter 12 applies. If that were so, the defendant would not have needed to make an application by means of a judicial request, as he in fact did, before the First Court. This Court considers that the exception which the defendant seeks to raise before the First Court is peremptory only in relation to the proceedings and therefore, as a dilatory plea on the merits, can only be raised, as a rule, *in limine litis*. Thus one must examine whether in this case there existed valid reason or reasons why this exception was not raised *in limine*(Article 728(2) of Chapter 12), or at least after the plaintiff company presented its evidence and before the defendant began presenting his own evidence (Article 158(11)).

There is also no doubt that as regards the issue of the plaintiff company's judicial representation and the position held by George Said when he swore the affidavit and when he filed the writ of summons, that position was, or could easily have been, known to the appellant defendant, since these were matters clearly emerging from documents — the Memorandum and Articles of Association — which were accessible to him. **If the appellant failed to carry out his checks before submitting his note of pleas, that is attributable to him**. Certainly, therefore, it cannot be said that after the hearing of 11 April 2006 he "discovered" something regarding the judicial representation of the plaintiff company or

regarding the office held by George Said which he could not have already known in August 1998 or before submitting his note of pleas on 12 November 1998.

Although it is true that the minutes of the Board of Directors' meetings, in which decisions such as that to initiate legal proceedings are taken, are not public documents like the Memorandum and Articles of Association, **nevertheless the requirement that allows respondent company to institute judicial proceedings was also accessible to the appellant through the said Memorandum and Articles of Association.**

Kashmiri Palace ltd vs Ian and Jacqueline Busuttil *FHCC*

In this case, it was held that in terms of article 181A of the COCP, a shareholder did not qualify to represent a Company in judicial proceedings. As the sworn declaration in the circumstances was not valid, this rendered null and void the claimant's legal proceedings under Article 789 (1)(d) of the COCP. The court, in this case, based its arguments on 2 principal provisions of law, namely, **article 141 of the Companies Act** and **Article 181A of the COCP**.

Article 141 of the Companies Act holds as follows;

141. (1) Where for any reason the representation of a company ceases to be vested in any person or persons, the company shall appoint another person or persons to exercise such function. The appointment shall be made by ordinary resolution taken at a general meeting notice of which shall be issued within fourteen days from the date when the vacancy occurs.

(2) The company may by ordinary resolution replace any person or persons vested with the representation of the company.

(3) **Where, and for as long as, the representation of a company cannot be exercised in accordance with the memorandum of the company, any director shall represent the company in judicial proceedings against it.**

The default position is **where the representation cannot be exercised in accordance with the Memorandum, that any director may proceed with such representation.**

Parklane Investments Limited vs Luigi and Pauline Portelli

30th July 2010

In this case, it was held that if a lawsuit was filed against a person in his capacity as director without actually mentioning *in representation of the company*, legal action was still deemed to have been taken against the company and not against such person on a personal basis. This is because notwithstanding the fact that in 1995 the law was amended in such a way that a company could be sued and sue in its own name, for many years after, claims were being made against the person and not against the company. **This judgement made it clear that you do not need to claim against the person representing, but instead you may claim against the company.**

If one of those appearing fails to indicate that he is acting on behalf of the company, serious consequences may emerge. We shall see that there is a number of Court Judgements that have confirmed the rule that a person who fails to indicate that he is appearing on behalf of a person becomes personally bound by the transaction.

Emanuele Borg pro et noe vs Romeo Schembri

CoA, 28th May 1973

In this case, the CoA stated that it is the duty of whoever is entering into a transaction to make it clear that he is acting on behalf of some other person. Otherwise, he would be personally bound on the transaction, with the other party being entitled to hold him liable.

Media Today Co Limited vs Mary Gauci

CoA 15th July 2016

In this case, the Court ordered Mary Gauci to pay the sum of approximately 10,000 EUR for promotional services carried out by Media Today Co Limited, **despite claims that she was merely acting on behalf of and in representation of another company,** called Libertis Malta. The defendant argued that she should not be liable for the debts due to Media Today Co Limited, since she never personally engaged into a juridical relationship with the latter, because both when signing the booking order, as well as when the applicant sought to be paid the amount, Mary Gauci never acted in her own personal capacity. In considering the case, the Court made a number of reference to a number of judgements, most notably to the case ***MCF Company Limited vs Charles Buhagiar*** *(15th June 2016)*. The relevance of this judgement is that the Court outlined a number of principles in relation to this issue.

First of all, the Court held that as a general principle, it is important to note that whoever enters into a contract must correctly know the identity of the persons in whose favour he is contracting and who, in turn, is contracting an obligation in his favour. Secondly, as observed in ***Bonnici noe vs Grima*** *(30th April 1992),* it is not unusual for a person to enter into a contract solely on his own behalf. This means that when a party enters into an agreement with another, it is justified to assume, both for his own peace of mind and for the security of commercial operations, that the person with whom he is contracting is concluding the contract for himself and not on behalf of someone else. **This all means that in order to ensure good faith, whenever a person is contracting on behalf of another, one must always clarify, from the very beginning, that he is acting on behalf of a Company**.

The Court made reference to what happens in the Italian Courts - as established in ***Laurence Formosa noe vs Silvio Felice*** *(6th October 1999)* - it was not enough for Gauci to rely on the simple declaration that she never negotiated in her own personal capacity, but **she was also obliged to expressly exhibit the authorisation to act on behalf of Libertis Malta.** The fact that the negotiations were being carried out by a LLC, and therefore by an independent juridical person, meant that it was the mandatary's obligation to indicate, in the clearest manner, to Media Today Co Limited that she was acting on behalf of another Company at the time the obligation was being contracted. **Should such person fail to make this fact known to the other party it would mean that he would be assuming personal responsibility for the business contracted by him and for the obligation arising from such business.**

The burden of proof in such a case falls **on the person alleging that the party is acting on behalf of someone else**. Evidence may include indications made on invoices and other statements, which must be analysed by the Court, as to whether or not it is clear in whose name one is acting. Thus, if the defendant states that he or she acted on behalf of someone else, then he or she must prove it.

The roles of the Shareholders & Directors of a Company

The Members / Shareholders are the owners of the company. For one to become an owner of a company, they must purchase shares in that company. A share represents a unit of ownership of the company. This notion of holding shares leads to the discussion pertaining to **share capital**. This is to be distinguished from **authorised share capital**, **paid up share capital**, and to the different types and rankings of shares. The question arises - if a company is owned by the shareholders, then what purpose do the directors serve? As a starting point, the term 'directors' refers to the management of the company. The board of directors are those individuals entrusted with the decision-making of the company. While the Companies Act makes no reference to the reason for which a company is set up, it is usually the case that Companies are set up to conduct business. **The Directors then take all the decisions**

pertaining to the business conducted by the company. When speaking of a company set up to run a hotel, for instance, the directors are responsible for deciding on the contractor to be appointed, the plot of land to utilise, the supply of the furniture for the hotel, etc.

There are several companies which have shareholders who are not sitting on the board of directors of that company. To this extent, Company Law serves to address both organs separately. In fact, historically, when Company Law began to emerge around 200 years ago, the idea of each shareholder serving as a decision-maker in the company lead to several impracticalities which eventually and ultimately lead to the idea of an individual director. The typical structure adopted by most modern companies is that a company's shareholders appoint a separate board of directors to manage the company in the best interests thereof. However, notwithstanding the responsibility vested in the Board of Directors in their decision-making capacity of the Company, **they are not all- powerful and are not free to act and decide on all matters freely and inconsequentially**.

A general principle which underlies the notion of the director is that they are not free to act as they please. Directors must keep in mind any restrictions of their powers which may be stipulated and established by the **memorandum and articles of association**. Directors need to act in the **best interests** of the Company, and must exercise care, due diligence, and skill in their day-to-day conduct of the company. The general rule is that the board of directors is vested with all of the decision- making powers which affect the operations of the company, **provided that the powers exercised by the Board remain in line with the Memorandum and Articles of Association**. Such an M&A, for instance, may state that the company may not purchase any immovable property worth over 2 Million Euros without first having attained approval by a majority of the shareholders in an EGM. Here, the directors' powers are thus limited. Another matter left outside the hands of the directors is the amendment of the M&A. Directors may not touch the M&A without there being an AGM. There are other matters, such as the raising of the authorised share capital applicable to a company, which may not be amended without there first being an AGM. The Company Act may also contain provisions which limit the powers and rights carried by Directors in their operations of the

Company, and thus one must consider both the M&A and the Companies Act in establishing the boundaries of the Directors' Powers.

The Role of the Management

In a company, there exists the role of the management. A company established to conduct the business of hotel running, for instance, would require employees to carry out the day-to-day business of the company's affairs. **As a rule, directors take care of the company's strategy and important decisions, whereas the management would handle the daily operations and affairs.** While it is not a fixed and enforceable rule, the directors of a company tend to meet once a month, or once every two months, for a few hours to discuss an agenda and to decide on important matters pertaining to the company's business. The business of the company is not solely run by the directors, but rather it is run by the directors together with the management and employees of that company.

The board of directors are very powerful In every company, but this does not necessarily equate to the day-to-day operations of the company being vested entirely in the directors. This is where the role of the management comes into play.

Assets & Liabilities of a Company

Assets, for the purposes of Company Law, refers to the movables and immovables owned by the Company. Such would be plots of land, vehicles, machinery, and perhaps even more importantly, **debtors**. Debtors are considered as assets of the company, since they refer exclusively to money or other assets which are owed by the debtor to the company. Liabilities, on the other hand, refer to money which is owed by the company towards other **creditors**. Creditors thus conversely fall under the company's liabilities.

The assets & liabilities of a company are what form the scope and purpose of running a company. Generally but not absolutely, a company is deemed to be doing well when its assets outweigh its liabilities. On the other hand, when liabilities begin to overwhelm assets, the company may be heading into a direction of insolvency. **Company Law heavily regulates the keeping of accounts of the company, in which assets and liabilities play a fundamental role.**

Among the various provisions in the Companies Act which regulate bookkeeping, one must note that a strong emphasis is placed on the fact that financial statements are to be produced in a timely manner. This is important because of a number of reasons. The shareholders are not involved in the operations of the company, since such affairs are left within the directors. Conversely, the shareholders are the owners of the company, and **thus they are owed an explanation and an updated report on the decisions being taken by the directors**. **The financial statements are pivotal because they serve as a reflection of the performance of that company**. The drawing up of these statements places a burden on the directors to draw the profit & loss accounts as well as the financial statements according to the regulations in place. Such statements must also be audited before being submitted, by an independent team of auditors. The law thus places a final responsibility on the directors, who must present these statements during every AGM. Being entrusted by the shareholders, directors may also be removed should their actions not be in line with the best interest of the company, according to the shareholders.

The financial statements are important not only to the directors and shareholders of the company, but also to the company's creditors. Suppliers and other creditors of the company might ask for previous financial statements in order to assess whether the company is credit worthy, before offering their services to that company. Financial statements are published on the MBR in order to allow creditors to assess the creditworthiness of the company they wish to conduct business with.

Other significant players which form part of the company are the employees and the state. The employees are not vested rights under the CA, but rather under Employment Legislation (typically reference is made to the EIRA, Chapter 452), Health & Safety Legislation and Data Protection Legislation. Even though we are not really concerned with employees, the management of the company needs to be aware that the company will have significant obligations towards employees.

Owing to the Company's legal status & recognition, it is also subject to the laws of the land.

Jurisdictional issues may arise, and thus sometimes a company's lawyer will be asked to establish and ascertain which laws apply to the matters at hand.

The Transfer of Business

In any business, such business will have a variety of assets, liabilities, and a host of business relationships. The business of a supermarket would own assets such as **cash, deposits, stocks, furnishings, fittings, office equipment, immovable property, intellectual property rights, etc.** On the other hand, the same business would also owe liabilities such as **bank facilities (loan, overdraft), suppliers which have not yet been paid, amounts due under a number of contracts, insurance arrangements and premiums, fees due to the auditors, etc**. Those third parties who owe money to the business are referred to as **debtors**, while those parties who are owed money by the company are referred to as **creditors**. Vis-a-vis the business relations with people, we must keep in mind the **employees, supplies, consultants, banks, service providers, etc**. All the arrangements pertaining to the entries in the business relations will in some way be reflected in at least one of the contractual transactions between the business and that third party. Let us imagine that the business is owned by an individual trader. Such individual trader is approached by a third party who intends to acquire the business. Let us imagine that the parties agree on the price for the sale and acquisition of the business. The transaction of the acquisition of the business will not be straightforward, if anything, it will be anything but straightforward. **This is because one will first have to ascertain the assets, liabilities, and business relations of the business**, because such assets, liabilities, and business relations will **necessarily be transferred from the owner to the third party**. It is thus in the interest of the third party to know exactly what the business owes, what it owns, and who the contracting parties are.

When it comes to the transferring of assets, the transfer of **cash, stocks, furnishings, fittings, stocks,** and **vehicles**, are rather straightforward, for most of such assets may be transferred upon delivery. When it comes to bank deposits, the transferral is a bit more complicated, since banks will not transfer sums between one person to another before conducting the relevant KYC and AML tests and checks. The transfer of immovable property may only be done via a public deed, and thus the formalities required by law must be followed. When it comes to the transferring of liabilities, we must know that the transfer thereof **always and necessarily involves the creditors.** When it comes to banking facilities, there is a creditor, who is the bank. If you are the owner of a supermarket who has several liabilities due, the owner cannot simply tell the third party that he must pay such liabilities. Liabilities are transferred **only if the creditor consents to such transferral**. The creditor will always have the right to seek the debt due from the **original debtor**. Thus, **liabilities may be transferred only if the creditor to that liability consents to the transfer.** This is referred to as a **novation *ex parte debitoris***. Thus, for a third party to acquire the business of a sole trader, the owner must transfer all of the assets and all of the liabilities to the third party before the transfer is deemed effective. On the other hand, if the third party wants to acquire the business of a company, these individual transfers of liabilities are not required. If the third party thus wants to buy the business of a company, they will agree on a price, and the transfer is done not by way of a transfer of business but rather by way of a **transfer of shares of the company from one shareholder to another**.

Thus, it is easier to transfer the business of a company, when compared with a sole trader, thus rendering such ease of transfer an **advantage**. This advantage is not restricted solely to LLCs, but also to partnerships en nom collectif and en commandite, because in these latter cases, instead of transferring shares, we would be transferring the interest of the partners per the partnership deed.

A company enjoys a separate juridical personality, as per article 4 of the Companies Act.

4.(1)A commercial partnership may be of the following kinds: (*a*) a partnership *en nom collectif*; or (*b*) a partnership *en commandite* or limited partnership; or (*c*) a company. (2) A commercial partnership other than a company may be formed for the exercise of one or more acts of trade. (3) A company may be formed for any lawful purpose and shall have the status of - (*a*) a public company; or (*b*) a private company. (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.

This separate juridical personality is to be isolated from the personal capacities of the shareholders who own such company. The company is distinct from whoever owns it. This characteristic is one shared not only by all companies alike, but also by all partnerships, be they partnerships en nom collectif or partnerships en commandite. The law dictates that a company enjoys a separate juridical capacity. This stipulation brings about a number of consequences, namely that;

- A Company is able to sue and be sued in its own name;

- A Company is capable of owning rights separate from those rights enjoyed by its shareholders;

- A Company is capable of owning assets and liabilities which are separate from those of its shareholders.

The Notion of Share Capital

We may recall that when distinguishing between the different forms of commercial partnerships we often refer to the notion of share capital. For Limited Liability Companies, capital is divided into shares. On the other hand, partnerships en nom collectif and partnerships en commandite have different structures of capital. For LLCs, capital is divided into shares, allowing for extended flexibility, which is **translated to the transferability of shares**. Before delving into capital, we must understand what capital refers to. Capital can take various forms, such as a loan, for instance, which would be coined the term loan capital. In order to better understand what share capital refers to, we will conduct a comparison between **share capital** and **loan capital**. Generally speaking, share capital can be defined as ***referring to those funds contributed to the company's resources by the shareholders by reason of the fact that they are holders of shares***. The fact that there are holders of shares can be traced to the latin origin ***qua shareholders*** (of shareholders). The holding of shares represents rights within a company.

On the other hand, **loan capital** essentially refers to a commercial expression typically attributed to **the funds borrowed by a company other than by short- and medium-term borrowing.** The majority of people utilise loan facilities when purchasing immovable properties. When an individual obtains a loan facility from the bank, the bank is a vulnerable party, which thus warrants the use of **security**, in the form of a **privilege** or a **hypothec**. Loan capital may take the form of **debentures,** which give a higher ranking of repayment in cases of insolvency. Whereas **share capital** refers to **rights within a company,** loan capital refers to **rights against a company,** because essentially, whereas a shareholder would supply capital to the company in exchange for shares, which represent **rights within the company**, a third party who supplies capital to the company by way of a **loan** has the **right to institute proceedings against the company for the repayment of the loan**.

Oreste Cilia vs Cilia Products Limited - dividends may be retained

First Hall, Civil Court, 22nd March 2018

In the above case, the applicant was a shareholder in the defendant company Cilia Product Ltd where he alleged he was owed a sum of approx. 43K Lm in a form of shareholder's loan. The amount was not contested, and the defendant company remained in default. On its part, the defendant company stated that the action was procedurally not founded in law as the action had been filed in the applicant's personal name as a shareholder of the defendant company to which he was not a shareholder.

What is most important to extract from this case is the analysis made by the court on the different forms of capital.

Considerations of Law and application to the case *de quo*:

It must be stated immediately that this **Court does not agree with the thesis advanced by the respondent company that the so-called shareholders' loans "are not loans at all but an accounting concept" or "a sui generis concept invented as a tool forming part of the machinery through which a commercial company operate**s."

The court corrected the defendant's argument, stating that the shareholders loan is not a to be deemed merely an accountancy method or a sui generis concept that was devised as a tool in order for a commercial company to be able to offer it. The court referred to **Andrew Muscat**, citing the following:

"The members of a profitable company generally expect to reap regular financial benefits in the form of dividends. They would also however, usually recognise that the company may

need to retain some or most of the profits to enable it to invest for example, in an upgrading or further expansion of its operations."

One of the most fundamental rights to any shareholder is the right to dividends. Professor Muscat, in recognising this fundamental right, holds that the dividend is called at the discretion of the board of directors. The company may require to retain the funds intended to be distributed as dividends in order to utilise such funds for company growth. When dividends are retained, however, it is only the shareholder who is effected, but not the party who issued the loan capital.

The Court also refers to **Ferran,** who states that *"In those private companies where most of the members are involved in the running of the company, substantial dividend distributions are rarely made. In these types of private companies, the members often consider themselves to be the owners of the business rather than as investors."*

The court continues, stating:

***Oreste Cilia vs Cilia Products Limited* – continued; share capital vs loan capital**
First Hall, Civil Court, 22 March 2018

Therefore, what is being claimed by the applicant in the present case represents undistributed dividends and also directors' fees, as results from the prospectus, given that Cilia Products Limited is debited with shareholders' loans listed under the heading *"Creditors: amounts falling due after one year"*, as shown in the company accounts at page 33 of the record.

It is also relevant to make reference to the definitions of 'share capital' and 'loan capital' which were already mentioned in part in the judgment. In the applicant's note of submissions, the term *loan capital* as defined by Professor Andrew Muscat was cited, where it is stated

specifically that: **"In contrast to share capital, loan capital represents rights against the company."**

The Court also refers to **Pennington's Company Law,** "*Loan capital appears on the liabilities side of a company's balance sheet in double columnar form and is enlisted beneath share capital and reserves, but unlike share capital, it does represent indebtedness by the company,* ***and holders of loan capital have the remedies of creditors to recover what the company owes them.*****"**

Holders of loan capital have the remedies for the creditor to recover what is owed to them. On the other hand, shareholders have no rights for actions to receive all which is owed to him. This is the crux distinction between share capital and loan capital.

Oreste Cilia vs Cilia Products Limited *- continued; dividends may be retained,* ***working capital***

First Hall, Civil Court, 22nd March 2018

"Once a final dividend has been declared, it becomes a debt due and payable to the members and cannot be revoked or reduced by any subsequent decision of the company."

In the case under examination, the dividends were declared by the Directors, but instead of being distributed, they were left in the Company so that they would form part of the working capital. The directors could, if they wished, have chosen not to declare any dividends at all, and in such a case no credit in favour of the shareholders would have arisen.

Thus, as aforementioned, when dividends are retained in order to establish company growth, they are coined the term **working capital**. However, in the case in question, the dividends were declared and called by the board of directors, yet they were retained anyways. Thus, once the dividends were called, they must abide by their obligation to pay such dividends, and the right to retain dividends to serve as working capital is lost. **Once dividends are called, they cannot be retracted.** In fact, the court acceeded to the request of the applicant, who was awarded the sum of approximately 84,000 euros.

Share Capital

We will now limit our focus on share capital. There is a lot of different terminology used to refer to share capital. This emerges even in our law. **Prof Muscat** is not very keen of these various definitions and terminologies which exist in relation to the same concept. Nonetheless, the fact remains that **article 69 of the Companies Act includes with it these different terminologies**. One must start with **article 67** of the **Companies Act**;

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.

This provision opens Part 5 of the Companies Act, and is the first of 200 provisions dealing with the Limited Liability Company. This article holds that a company's constitution consists of **capital** which is **divided into shares**. Each share of a company carries with it a **nominal value**, which is always a fixed amount (for example euro). Thus, for instance, 1 Share in the Company ABC limited carries a nominal value of 1 Euro, which in private companies is a very common for nominal value). The nominal value of a share is stated in the M&A, whereas the market value of a share is dynamically altered per the market demand. If Company ABC is owned by 2 shareholders, who together hold 600 shares each, then the

issue share capital is equal to 1200 Euros, since each share carries a nominal value of 1 euro.

There is a minimum imposed by law with which the company needs to be registered. That minimum is 1165 euro if the company is a private company. If the company is a public company, then the minimum is around (not precisely) 47,000 euro.

When the Companies Act 1995 was promulgated, the currency at the time was the Maltese lira. The minimum share capital at the time was 500 Maltese liri and the shared capital for a public company was 20,000. Maltese liri. In subsequent amendments what the legislator did was convert these liri into euros. Significantly though there is no maximum.

In the English Judgement ***Bolan Trustees vs Steel Brothers Limited,*** the term share was defined as being *not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.* Further, in ***Re Paulin*** *(1935)*, the English Courts defined the term share as being *not a sum of money, but rather an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money or less amount*.

Authorised Share Capital

The **Authorised Share Capital** refers to the **total of the nominal value of the shares which a company may issue**. This Authorised Capital must be included in the Capital Clause of the Memorandum of Association. This authorised capital is also referred to in **article 69 (1) (f) of the Companies Act as *the amount of share capital with which the company proposes to be registered.***

69. (1) (*f*) the amount of share capital with which the company proposes to be registered (hereinafter referred to as "the authorised capital"), the division thereof into shares of a fixed amount, the number of shares taken up by each of the subscribers and the amount

paid up in respect of each share and, where the share capital is divided into different classes of shares, the rights attaching to the shares of each class;

Article 69 of the Companies Act establishes a list of declarations which must necessarily be included in the Memorandum of Association. The issue is that **authorised share capital** is not, strictly speaking, capital. It only refers to the maximum amount of nominal capital which may be utilised and distributed by a company. In this respect, it is important to be aware of the fact that a number of text writers, including **Professor Muscat**, are of the opinion that although the term **authorised share capital** sounds important, in practical terms, it fulfils no identifiable credit protection role.

In order for the authorised share capital to be increased, one must amend the Memorandum and Articles of Association of that particular company. This may only be affected by way of an **extraordinary resolution**. This updated version of the M&As must also contain any and all relevant updates which do not per se qualify as amendments to the M&A but which nonetheless impacted the contents of the document.

Some M&As say that any increase in the share capital needs an approval of the shareholders, and some say that any increase in the share capital within the authorised amount is at the disposal of the directors so they would have discretion. Thus, one must look at the M&As. The directors cannot increase the authorised capital because they can only do so with an extraordinary resolution.

Issued Capital

Another term used by the law is the term **Issued Capital**. The issued capital is referred to as the **total of the nominal value of the shares which are allotted to shareholders**. In real terms, issued capital is that part of the authorised capital which is actually distributed from the company and taken up by the shareholders. Thus, if a Company is authorised to distribute EUR500,000 worth of shares, and has issued only EUR200,000 worth of shares, it is only allowed to issue an additional EUR300,000 at any point in the future.

Paid Up Capital

Paid up Capital refers to the amount of issued capital which is **paid up** by the shareholders. The amount of paid-up capital is obtained by multiplying the number of shares taken up by the subscribers with the corresponding amount paid up in respect thereof.

It is possible for a shareholder to pay up only half of the shares which they have purchased. As a rule, shareholders are **required to pay for at least 20% of the share which they have purchased.** Although most companies have shares that are fully paid-up, there are still some cases where shares are not fully paid up. If a share is not fully paid up, the shareholder is liable to pay for the remaining balance of those shares. If the company runs into financial difficulties, the Board of Directors may opt to call to all shareholders with outstanding balances to pay up the remaining balances of their shares. **In any case, shareholder rights are not affected by reason of shares not fully paid up**.

One must distinguish between the **true value of a share** and the **nominal value of the share**. The former represents a fair market value, whereas the latter refers to a simple historic amount. The true value of a share does not usually correspond to the nominal value of a share. If you had to have a look at any memorandum, we will usually come across a nominal value of 1 Euro. A share with a nominal value of 1 Euro may, for instance, in 4 or 5 years after its issue, be worth 100x that amount, if in the meantime the Company becomes

successful and has a lot of retained earnings. On the other hand, however, a share of a nominal value of 100 Euros may be completely worthless if the company becomes insolvent. In order to ensure that shares do not lose their value, and to protect the existing shareholders, the law provides for the possibility that the articles of association of many private companies contain what are referred to as **pre-emption provisions**. Pre-emption provisions

require a shareholder who wishes to dispose of his shares to first offer his shares to the existing shareholders at a fair value, to be determined by the auditors of the company, before offering such shares to third parties.

Moreover, shares may be **paid in kind**, meaning that the shareholder would agree to provide an asset of equal monetary value to the balance to be paid in consideration of the purchased shares. A problem arises - what if a shareholder claims that the van which he is offering in consideration of his purchased shares is valued at EUR25,000 (to pay for 25,000 shares of EUR1 each), when in reality his van costs less? The law solves this problem by way of **article 73 of the Companies Act**;

73. (1) The consideration for the acquisition of shares in a company whether on the original subscription or a subsequent issue, **may only consist of assets capable of economic assessment,** and furthermore, future personal services and in general any undertakings to perform work or supply services may not be given by way of consideration.

Thus, the law requires that the asset offered in consideration for the acquisition of shares be

capable of economic assessment. The value of the asset will then be determined by an independent expert, and the exchange of shares in kind will only be made possible if the value of such asset is **at least equal to the value of the shares being issued**.

When shares are issued, whether for cash or in kind, evidence must be provided to the registrar of companies that the consideration has actually been paid. If the payment is cash, then one has to show a deposit slip from the bank of the amount of the share capital which

has been deposited. In the case of a transfer of a vehicle for example, two things need to be done.

1. To begin with a valuation by an expert is that the asset is worth the value of the shares being issued plus a premium, so if they are 600 shares of a nominal value of 1 euro each plus a premium of 49400, then the valuation of the expert has to show that the vehicle is worth at least 50000 euro.
2. Then there also needs to be some document showing that the ownership of the vehicle has also been transferred to the company. As a movable, a vehicle would only require a private writing. If the asset is an immovable such as a property, then it would require a public deed.

Share Premium

The share premium refers to the price and value of a share **over and above** the nominal value of that share. **The premium is thus the term used to define the difference between the nominal value and the market value of a share which a shareholder would pay to become involved in the company.**

Classes of Shares

It is possible for a company to have **different classes of shares**. The general principle is that

whatever the size of the company, that company will have one class of shares each of the same nominal value, the same voting rights, the same return of capital on a winding up. In practice, when a company has only one class of shares, the shares are referred to as ***ordinary shares***, or simply as *shares*. It is, however, possible for a company to have different classes of shares. For instance, a Company may utilise and dispose of ***ordinary 'A' shares*** and ***ordinary 'B' shares***. A company may elect to use shares which ***do not have voting rights***, for instance. What distinguishes one class of shares from another are the **underlying rights** conferred upon the shareholder as per the M&A. The different classes of shares often represent different rights and different interests within a company. The most common example of such takes the

form of a clause in the M&A which specifies that each group will have the right to appoint one or more directors on the board of directors. It is possible to have different classes of shares that distinguish between **preference** and **non-preference shares**. Typically, **preference shares give the holder the right to a preferential dividend over the ordinary shares.** Such preference shares will, in turn, carry little to no voting rights. Thus, the shareholder must opt to purchase either the share which has a preferential dividend yield or else to purchase a share which carries better voting rights. This classification of shares would serve of interest for those investors who would like to financially support the company with little to no interest in the management and day-to-day decision making of that company's affairs, provided that he will receive his dividend in return.

The norm is that every company is to have, at all times, ordinary shares. As the jurist ***Pennington*** observes, the rights of ordinary shareholders are essentially **residual**. It is thus unnecessary for them to be set out explicitly in the M&A. What ***Pennington*** argues is that since the rights attached to an ordinary share are residual, and since the company is composed of 2 organs (the Shareholders & the BoD), those powers that are not directly vested in the BoD are, by implication, the residual powers of the shareholders. ***Pennington*** is of the opinion that things should remain as such - the individual rights attached to an ordinary share should **not** be stated in the M&A, in order to avoid conflict between the terms of the M&A and the terms described by law. Further, if too much is stated about ordinary shares in the M&A, a conflict may inadvertently be created with the express rights of the holders of preference or other higher-ranking classes of shares.

Gordon Mizzi et vs Dr John C. Grech - *no changes if shareholder rights are prejudiced*

Court of Appeal, 29 April 2008

In this case, the Court decided that **a Court is obliged to disallow any change or variation in the classes of shares if it is satisfied that the proposed change would unfairly prejudice the holders of such shares.**

Ordinary shares vest in the shareholder the right to dividend, the right to vote, and the right to return of capital on the winding up of the company. Let us take the example of a company with 2 shareholders, A and B each of 1000 shares. The default position is that every share carries one vote. In most fields of company law, however, parties agree otherwise, with such agreement being contained in the Memorandum and Articles of association. It may be that the shares allocated to A represent 1 vote per share whereas the shares allocated to B represent 2 votes per share. **When speaking of dividends, we understand the distribution of profits to the shareholders.** A company can therefore only distribute dividends if the company has generated profits at the end of the year.

The profits that are capable of distributing dividends have to be, in terms of Company Law and in terms of Accounting Standards, have to be **distributable**. Usually, with ordinary shares, the quantum of dividend that each ordinary shareholder is entitled to is related to the nominal value of the shares that he or she owns in the company. Such distribution, however, is contingent both on the Memorandum and Articles of the Company as well as the **terms of issue** which were agreed to upon the purchase of the shares. We must also refer to the **return of capital** - if A and B have contributed 1000 euro each in terms of 1000 shares each of a nominal value of 1 Euro, we must determine, in cases of liquidation, what assets are owned and what liabilities are burdened by the company, the return of capital may not necessarily be of 1000 euros. Let us say that upon liquidation, the Company owns 10,000 Euro worth of Assets and owes 7,000 Euro worth of liabilities. The Company is said to be **solvent**, since the Company has 3,000 Euros worth of Capital left. The Return of Capital for that company is worth 2,000 Euros, leaving a Capital of 1000 Euros which will also go to the shareholders in equal proportion. Let us consider a different scenario. This time, the Company owns 10,000 Euros worth of assets, but owes 12,000 Euros of liabilities. In this case, the Company is **insolvent**, meaning that the shareholders will receive no return of capital at all - they will have lost its investment.

Now, we will introduce the notion of **preference shares**. There is no real definition in the

Companies Act for preference shares. The Companies Act also does not contain any real information on the rights attributed to preference shares. Thus, for information on preference shares, we must refer to the terms in the Memorandum of Association as well as the Terms of Issue agreed upon by the shareholder. Let us imagine that a Company has issue both ordinary shares and preference shares.

To begin with, at any point in time, a Company must have issued Ordinary Shares - a company cannot have issued solely preference shares. In the large majority of Companies, the share capital is comprised of solely ordinary shares, without any preference shares being issued. Preference shares are special because they have some kind of preference over ordinary shares, **with such preference being defined by the Memorandum of Association and the Terms of Issue.** Normally, preference shares will have a preferential right to dividend. Normally, this right is a right to a given percentage of the nominal value taken up by the shareholders, and possibly some kind of a preference also on the return of capital. Preference shareholders may also have some kind of advantage in terms of voting rights, but this is not always the case.

Let us imagine that there are 4 individuals who band together to form a company between themselves in a particular strain of business. When discussions take place between themselves, they will inevitably discuss the quantum of investment that they would like to contribute to the Company. They may decide to invest in equal proportion. Let's say that these 4 shareholders would like to invest 200,000 Euros in the Company, split between all 4, thus paying 50,000 Euros each. In their discussions, 2 of the shareholders would like their shares to be issued as preference shares, with a coupon of 8%. Such coupon is **that percentage on the capital** or on the **nominal value** to which the preference shareholders would be entitled, on a yearly basis, out of the profits of the Company, in preference to those shareholders who are ordinary shareholders. In the first year of operations, the financial statements of the Company show that the Company has made distributable profits equal to 6,000 Euros. The preferential shareholders are therefore be entitled to 8% of the 100,000

which they have invested between themselves. Thus, both preferential shareholders are entitled to 8,000 Euros dividends between themselves. Thus, the 6,000 Euros worth of distributable profits are distributed entirely to the Preferential Shareholders equally, with the other shareholders receiving nothing. Let us say that the next year, the Company has made 14,000 Euros worth of profits available for distribution. The Preferential Shareholders will take 4,000 Euros Each, leaving a balance of 6,000 Euros to be distributed between the ordinary shareholders. In its third year, the Company makes 38,000 Euros worth of Distributable Profits. In this scenario, the preferential shareholders will receive only 4,000 Euros each, whereas the ordinary shareholders will receive 15,000 Euros each. This, however, is always subject to the **terms of agreement** and the **Memorandum of Association**, and thus these documents must be our starting points. Thus the preference share always gives a fixed amount.

A preference share may also be **cumulative**, meaning that if in any 1 year, the preference

shareholders do not receive their entitlement to their coupon, then the shortfall will become a claim in the subsequent years, until they have received all that they have been entitled to. A preference share may also take the form of a **Participating Preference Share**, the shareholder of which will have the right to participate equally with the other shareholders over any amount of profits after the preferential dividends have been paid. In the absence of any information in the terms of the Memorandum of Association and in the Terms of Issue, there are U.K. Judgements which state that **preferential shares are deemed to be cumulative by default**. If the board of directors select to retain the distributable profits as capital to be used by the Company in the next years, the **cumulative preference shareholders** are still entitled to claim their promised dividends (coupon) in the coming years. The Board of Directors have the right to suggest a non-payment of dividends precisely for the retaining of earnings, if they believe that it is in the best interest of the company's longevity to do so. While this is the right of the Board of Directors, the Shareholders are entitled to change the directors if they are unhappy with the decisions pertaining to the distribution of dividends. However, more often than not the shareholders accept the decisions

taken by the Board, since most times the Directors would make such decisions acting in good faith. See ***Staples vs East Man Photographic Materials Co*** *(English Courts 1896)*.

It is important to note that of the different commercial partnerships that we have in our law (LLC, partnership en nom collectif, partnership en nom commandite), the notion of limited liability is a characteristic pertaining solely the Limited Liability Company (and in the case of the limited partners in the partnership en nom commandite). The notion of limited liability plays a significant role in the case of the LLC, since shareholders are protected in that they are only liable up to the amount unpaid of their shares, per **article 67 of the Companies Act;**

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.

Some argue that the limited liability aspect shaping the Maltese LLC is unfair on the creditors of the company. This is because while the shareholders enjoy all the profits and dividends attributed to them, they are only liable up to their initial investment. The counterpart to this argument is that creditors are very well aware of the risk they are admitting to when they are contracting their credit with the companies. Besides this, one of the important rules that attach to companies is the **obligation**, on a yearly basis, to file audited financial statements. If one examines the audited FS of a company, one should be able to ascertain whether the company is in a sound financial position or not, giving creditors the foresight and knowledge as to the state of liquidity of the company and their ability to pay credit.

Furthermore, limited liability is a privilege which comes at a cost. When you are dealing with an LLC, you are dealing with an entity which is very highly regulated, certainly by the Companies Act but also by other pieces of legislation which impose costs and obligations on companies, such as the obligation to disclose the Financial Position of the Company via the publication of Audited Financial Statements, which tend to come at a timely and monetary

cost. Another cost is the risk of the Directors in their decision making, who must abide by the various obligations which come with the running of a company. If such obligations are properly carried out, then the risk of insolvency goes down.

Redeemable preference shares

The companies act allows for preference shares to be issued as redeemable preference shares. In practice when preference shares are issued they probably will be issued as redeemable. Redeemable preference shares means that these redeemable preference shares can be redeemed or bought back by the company at some time in the future. Typically, but not necessarily always so the company will have the right as some stage to pay the preference shareholder the capital amount and take back those redeemable preference shares and effectively cancel them. In doing so the company will be redeeming those redeemable preference shares.

The articles could say that they are redeemable by the company after the lapse of say 6 years after the company's incorporation. The request for the redemption may come from the shareholder itself. There may be a provision in the article that the shares are at the option of the shareholders to be redeemed after a period of 5/6 years and there would be provisions regulating how the procedure works.

Acquiring the ownership of a share

A share is a fraction of the capital of the company. It represents the shareholders' proportionate financial stake in a company. It is also a measure of the shareholders' interests in the company and the basis of his membership rights. The easiest way to become a shareholder is by subscribing to the Memorandum of Association. Such subscription denotes the individual's original signing on the M&A. The second way of becoming a shareholder is to is by being **allotted** shares, whereby an increase in share capital is translated to the issuing of new shares. A third way of becoming the owner of a share occurs when there is the **transfer of shares**.

Original subscription denotes the subscribers of the M&A who become the first members of the company. A person may also become a member of a company via **allotment**, which is the process where a person can also become a member by being allotted shares in the company following an issue of shares.

There are thus 3 methods of acquiring the ownership of a share;

1) Original Subscription;

2) Allotment;

3) Transfer of Shares.

When the transfer of shares is done between persons alive, we refer of a **transfer of shares *inter vivos*.** On the other hand, when there is a transfer of shares owing from the death of a shareholder, we refer to a **transmission of shares *causa mortis***, which may arise when a child inherits the shares of his late father, for instance.

Essentially, the mode of **transfer of shares *inter vivos*** would comprise a disposal of shares by way of a sale, exchange, compromise, or donation. On the other hand, **transmission of**

shares causa mortis appears to refer to a disposal of shares upon the death of a shareholder whereby his shares devolve to his heirs. **One ought to consider the Courts' interpretation of the juridical nature of the rights conferred upon by shares.** The transfer of shares is regulated in considerate detail throughout the provisions of the Companies Act. We refer to **articles 118-123** of the Companies Act in this regard.

118. (1) Notwithstanding any provisions contained in any other law, a transfer of shares in or debentures of a company **shall be made in writing.**

(2) It shall not be lawful for a company to register a transfer of shares in or debentures of the company unless a proper instrument of transfer or an authentic copy thereof has been delivered to the company:

Provided that, without prejudice to any obligation arising under the provisions of the Duty on Documents and Transfers Act, nothing in this article shall prejudice any power of the company to register as shareholder or debenture holder any person to whom the right to any shares in or debentures of the company has been transmitted *causa mortis*.

(3) This article shall not apply to shares or debentures of a company held or evidenced in a dematerialised form or represented in book-entry form as immobilisation.

Article 118 deals with the transfer of shares and debentures, while **article 119** speaks of the **registration of the transfer of shares**. **Article 120** then deals with the **issue of certificates**. **Article 123** deals with the **register of members**. **Prof Muscat** has a chapter dedicated to the disposal and acquisition of shares.

The companies act distinguishes between public companies and private companies. With respect to **private companies**, the Companies Act requires the M&A to **impose restrictions on the transferability of shares.** However, in the case of Public Companies, the law is silent. Typical examples of restrictions on the transferability of shares often take the forms of **the pre-emption clause** and the **directors' discretion to refuse a share transfer**. The pre-emption rights are important because they ensure that other rights in the company, such as dividend rights, are not diluted. On the other form of restriction, a director would have the discretion to refuse to register a share transfer. This refusal is bound by the general principles of law, in that a director must observe the basic principles of **bona fide,** because directors hold fiduciary duties with respect to the company. The law, however, does not impose a duty to give reasons for such a refusal. This duty, however, may be added to the articles of association.

It is only the shareholders who signed the shareholders agreement that are bound by the agreement. Thus, in practice, you may have a situation whereby while the M&A only includes the pre-emption clause, the shareholders' agreement may hold stricter rules and restrictions which must be abided by those shareholders who decided to sign the agreement.

Members vs Shareholders of a Company

While in practice the terms are often used interchangeably, the law distinguishes between a

shareholder and a **member of a company**. We have stated that a shareholder has a prima facie right to transfer shares, subject to the restrictions found in the Articles of Association or in the Shareholders' Agreement. Such restrictions serve as legal tools for the existing members to control the membership of the company.

Furthermore, by the fact that a shareholder is a holder of shares, he becomes a member of an

association. The right to transfer shares is a significant power in the hands of any shareholder. The principle is that a shareholder has a prima facie right to transfer his shares. In practice, there are restrictions to the transfer of shares. Any restrictions, however, on the rights of transfer must be stipulated in the Articles of Association or in the Shareholders' Agreement. **A person may only be recognised as a shareholder, for the purposes of the Companies Act, if his name is entered into the register of members**. **Prof Muscat** highlights a practical problem, in that in practice most companies do not keep a register of members, and those who do, fail to update it.

SB Fiduciary Limited vs Crocodile Limited et *- member vs shareholder*

FHCC, 29 January 2015

While every Act carries, in its article 2, a list of key definitions, with regards to the **minority shareholders' action,** per **article 402**, the definitions pertinent to this action are found under article 402 itself. In this case, the court distinguished between **member** and **shareholder**;

L-ewwel subinciz tal-Art 402 jibda bil-kliem *any* ***member*** *of the company who complains ...* (enfasi u sottolinear tal-qorti).

Article 2, Companies Act: Member: *"except where otherwise specifically defined, means a shareholder of a company and a partner in any other commercial partnership."*

Article 2, Companies Act: **Shareholder**: "*a person entered in* the register of members of a company pursuant to article 123 or the bona fide holder of a share warrant referred to in article 121"

Specifikament ghall-fini tal-Art 402, il-legislatur ried iwessa` t-tifsira ta` "*member*" ghall-fini ta` dik id-disposizzjoni billi fis-subinciz (6) ighid;

Article 402 (6), Companies Act: 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."

"What is stated by Andrew Muscat (op. cit.) includes a footnote which reads as follows:

The terms "shareholder" and "member" are interchangeable. ***In English law****, although the terms are often used interchangeably, there is in fact a distinction.* ***Thus, a company limited by guarantee has members but it does not have shareholders****. And the holder of bearer shares does not become a member, since entry in the register of members is necessary for this purpose (see section 122 of the UK Companies Act 1985 which has been restated by section 112 of the UK Companies Act 2006).* ***In Maltese law****, however, the holder of a share warrant is* ***a "shareholder", and "member" unless otherwise specifically provided means a shareholder*** *[see article 2(1) Companies Act].*

…

Regarding the action as brought against Crocodile Limited, the Court observes that it is not supported by evidence that the transfer of shares in favour of the applicant company in Crocodile Limited was registered in the company's register of members in accordance with Article 119 of Chapter 386. It is also not supported by evidence that the tax due on the alleged transfer of shares was paid in accordance with Article 120(2) of Chapter 386.

Since it has not been proven that the applicant company qualifies as a "shareholder" of Crocodile Limited under Article 2(1) of Chapter 386, and therefore cannot qualify as a "member" of Crocodile Limited, this Court, without the slightest hesitation, states that the applicant company is *ex lege* precluded from instituting the present action."

Since Article 2 of the Companies Act makes a cross-reference to the term ***shareholder***, we must also understand what ***shareholder*** means. The judgement refers to **Article 402(6),** wherein the legislator was clear in his intentions to extend the definition of **a member.** The definition of a member is thus deemed to include a person entitled at law to **represent the interests of a deceased member**, a person to whom shares in a company have lawfully devolved by way of **testate or intestate succession**, and a **trustee.** It is thus clear, at a glance, that **section 402 (6) provides for a wider interpretation of the term than that contemplated in section 2 of the companies act.**

In its conclusions, the Court pointed out that **no evidence was brought** to prove that the transfer of shares in favour of the plaintiff company was registered as required by **article 119** of the Companies Act in the register of companies. Furthermore, the Court observed that no evidence was brought to demonstrate that the tax to be paid on such transfer was actually paid.

As a fact, the Companies Act contains special provisions dealing with the acquisition and transfer of shares (s.118-123 of the Companies Act). We have seen that the term ***member,*** per s.402, is wider in meaning than that defined under s.2. The plaintiff had to prove that its company fell under the definition of *member*. It was later revealed that the company had been in breach of the procedural requirements (filing of the **Form T, failure to update register of Members)** per **articles 118-123** of the Companies Act, which thus warranted the Court's dismissal of the action which the plaintiff sought to bring forward, owing to a **lack of locus standi**, since the plaintiffs did not fall under the definition of shareholders for the company.

This case manifests the practical issues which emanate from the technicalities of the definitions contained within the Companies Act. It is precisely for this reasons which warrants a proper comprehension and studying of these terms.

Another instance where the validity of a share transfer agreement was contested (albeit unsuccessfully) was demonstrated in the case ***Dr Peter Borg Costanzi pro et noe vs Carmelo Micallef et.*** This case concerned a claim for the payment of a sum due by the defendants in favour of the plaintiff as consideration for shares transferred by the plaintiff in favour of the defendant. In this case, shares were transferred by virtue of a private writing dated the 9th of June 1995, in exchange for a consideration. The balance was due to be paid at agreed intervals. It transpired that the defendants failed to pay the balance of the consideration for the shares amounting to approximately 10,000 LM. The plaintiff instituted proceedings before the FHCC regarding the debt that was allegedly certain, liquid, and due. The defendants argued that the plaintiffs' claims were unfounded in fact and in law, since the share transfer agreement of the 9th of June 1995 was null and void. The defendants argued that they had accepted to buy such shares from the sellers on the basis of **relative information,** such as current annual turnover levels and the gross profit margin of the company. Such information was provided to them by the sellers as established in Clause H of the Share Transfer Agreement. The defendants continued to argue that the information provided did not reflect the truth, thereby vitiating the defendants' consent on the agreement, with the consequence of nullifying the same agreement. The sellers of the company had failed to honour their contractual duties deriving from the share transfer agreement by, inter alia, failing to assist the defendants when they faced problems with suppliers, while also failing to introduce the defendants to potential clients, and furthermore they failed to teach the defendants about the business of the company. This was such so as the defendants were claiming that the plaintiffs ought to refund the amounts paid as well as compensation for damages. On their part, the plaintiffs brought about several procedural arguments. The plaintiffs stated that the claim for refund was prescribed, in terms of **article 1027 of the Civil Code**. They also claimed that the claim to vitiate the contract was null and prescribed in terms of **article 1222 of the Civil Code,** while the claim for damages was prescribed by **article 1253** of the Civil Code. The Court focused on **article 1222** of the Civil Code, which states;

Civil Code; 1222. (1) Save where the law in any particular case prescribes a shorter period, the right to bring an action for the rescission of a contract on the ground of violence, error, fraud, or the disability of a person interdicted, or minor, shall be barred on the expiration of two years.

(2) The same rule shall apply with regard to any obligation which is without consideration, or is founded on a false consideration.

At first instance, the FHCC accepted the claim of prescription, thus rejecting the claim that the disputed share transfer agreement was null, in turn confirming its validity and ruling in favour of the plaintiff. The defendants then appealed, on grounds of misinterpretation. On appeal, the principal argument was that it was far too late to declare the share transfer agreement null, since over 4 years had passed, and furthermore, the defendants were aided by professionals when the said agreement was drawn up. Another argument brought was that if the business had really decreased, this was due to the defendants themselves, with no blame being imputed to the plaintiffs. What is of interest in this case is the analysis carried out by the CoA, where the Court examines the clauses on the share transfer agreement. The court analysed the disputed clause, which read as follows;

Dr Peter Borg Costanzi noe vs Carmelo Micallef et - *invalid share transfer agreement*

CoA, 27th February 2009

"vendors undertake to cooperate and help purchasers in respect of any problems they might encounter with their suppliers",

"vendors undertake and guarantee that Australian suppliers will retain current agency agreements with the company ... subject to turnover minimum of four containers per annum",

"vendors undertake to introduce purchasers to existing and potential clients and to educate them in the business know-how",

"vendors declare that current annual turnover levels are LM75,000 with a Gross Profit Margin of 20 per cent average."

Thus, the Court had to interpret these provisions in line with both the Companies Act provisions on the Share Transfer Agreement as well as in line with the Civil Code provisions on prescription and contract. Reference was made to **article 966** of the Civil Code, dealing with the conditions essential to the validity of contract;

966. The following are the conditions essential to the validity of a contract:

(*a*) capacity of the parties to contract;

(*b*) the consent of the party who binds himself;

(*c*) a certain thing which constitutes the subject-matter of the contract;

(*d*) a lawful consideration.

In this case, the argument was that **consent was vitiated** on the grounds that the plaintiffs had deceived the defendants upon the signing of the agreement, on the grounds ***fraus omnia corrumpit,*** *per* ***article 981 of the Civil Code;***

981. (1) Fraud shall be a cause of nullity of the agreement when the artifices practised by one of the parties were such that without them the other party would not have contracted.

(2) Fraud is not presumed but must be proved.

Naturally, the plaintiffs claimed that the books presented reflected nothing but the truth. The Court stated that there was neither fraud nor deceit, since ultimately the increase in turnover depended on the persons running the business. Martin Bezzina (the shareholder of 1 share) in fact informed the Court that there was a lack of enthusiasm on the part of the defendants. One of the defendants had been running the business part time. The Court agreed that the sellers had done their utmost to help the defendants. The rest was left in the hands of the defendants, in that the business could only progress with their participation and effort. Perhaps due to a lack of experience, the defendants failed to succeed. Regarding the guarantee that Australian suppliers would retain agency agreements with the Company, the Court held that no proof was brought to show that the condition requiring a turnover minimum of 4 containers per annum was indeed fulfilled by the defendants. **The outcome of all this was that the Court, on the basis of the above, held that there was no element of fraud in the drawing up of the Share Transfer Agreement, and therefore, the defendants' consent was not vitiated.** There was an agreement between the parties and a sum which was due which had to be paid in consideration of the shares transferred.

The Court of Appeal rejected the defendants' appeal and confirmed the judgement of the First Hall (Civil Court).

In the aforementioned judgement, of ***Dr Peter Borg Costanzi noe vs Carmelo Micallef et,*** we find that the typical content of a Share Transfer Agreement consists of the seller's information, buyer's information, the number of shares being transferred, consideration that is to be paid, commencement of the transfer of shares, method of payment and any other subsidiary clauses.

Adrian Busietta pro et noe vs Philip Gatt pro et noe - *resolutive conditions & STAs*

CoA 30 May 2008

In this judgement, the Plaintiff entered into a public deed with the defendant before a notary, to sell his shares to the defendant. The Plaintiff had resigned from his directorship, but on his part, the defendant had not paid the full price of the shares to the plaintiff as had already been agreed to in terms of the share purchase or the share transfer agreement. The Court decided, in this case, that there is a **resolutive condition,** in that the agreement entered into by the parties was of a commercial nature, thereby meaning that **article 117 of the Maltese Commercial Code** was applicable. For this reason, the Court decided that the share purchase agreement was null between the parties and that the decision would have a retroactive effect with regard to third parties.

The Capital Maintenance Doctrine

The notion of SJP combined with limited liability produces a very flexible and advantageous vehicle through which investors can invest in a business with certain reassurances with respect to their liability exposure. These features are the cornerstone of company law.

With these advantages come a real possibility of abuse. In order to address this abuse there are certain mechanisms which have either been devised by the courts themselves or been incorporated into our law. One of the features that the companies act includes is the notion of having minimum thresholds

This doctrine essentially requires that the capital injected within the Company is not taken out to the detriment of the Shareholders. A Company is required to have an authorised share capital and a minimum issued share capital. You cannot incorporate a company unless you deposit and show proof of this deposit. Different minimum capital requirements apply, depending on whether company is **private** or **public**. A private company is required to have a minimum ASC of 500LM, while a public company is required to have one of LM20,000. Where the authorised share capital is equal to the minimum, it **shall be fully subscribed in the memorandum**, and where it exceeds the minimum, **at least that**

minimum shall be subscribed in the memorandum. This effectively means that the minimum issued share capital of a private company must be of 500LM, and 20,000LM must be issued in the case of public companies. The minimum share capital requirement applies also when a company is re-registered as a public company. The **minimum ASC and minimum Issued Share Capital** are established by **article 72** of the Companies Act;

72. (1) The authorised share capital of a company shall be –

not less than forty-six thousand and five hundred and eighty-seven euro and forty-seven cents (**46,587.47**) subscribed by at **least two persons** in the case of a **public company**; or

not less than one thousand and one hundred and sixty- four euro and sixty-nine cents (**1,164.69**) subscribed by at **least two persons** in the case of a **private company**.

(2) Where the authorised share capital is equal to the minimum aforesaid, it shall be fully subscribed in the memorandum, and where it exceeds such minimum, at least that minimum shall be subscribed in the memorandum.

(3) In the case of a public company, not less than twenty-five per cent, and in the case of a private company, not less than twenty per cent, of the nominal value of each share taken up shall be paid up on the signing of the memorandum.

(4) The ordinary shares of a company shall not be redeemable, and every company shall at all times have ordinary shares.

(5) Only preference shares which are to be redeemed or are liable to be redeemed by the terms of their issue shall be redeemable, and other shares in a company may not be converted into redeemable shares.

The public company has a higher amount of minimum issued share capital because of **Article 6 of the Second EC Directive on Share Capital and the Classification of Companies**. Article 6 of this directive was intended to allay the concern that the discrepancies between various EU Member States on this matter would affect the **freedom of establishment** and channel capital to those countries with more 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 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 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.

Furthermore, per **article 72 (3)** of the Companies Act, there is a **minimum percentage of the nominal value of each share which must be paid upon the signing on the M&A**.

72 (3) In the case of a public company, not less than twenty-five per cent, and in the case of a private company, not less than twenty per cent, of the nominal value of each share taken up shall be paid up on the signing of the memorandum.

Thus for a public company, **at least 25% of issued shares must be paid up**, while in the case of private companies, **at least 20% of issued shares must be paid up**. These rules apply **even upon the first signing of the M&A**.

All of these rules pertaining to the **capital** of a Company owe themselves to the **Capital**

Maintenance Doctrine, which purports that the Company is to maintain the capital of the company according to the **requirements established by law**. Therefore, in order to protect creditors the doctrine of capital maintenance was developed and essentially the doctrine is composed of a number of rules that firstly req**uire that a company obtains the capital which it has purported to raise** and secondly that **the capital is maintained subject to the requirements of the business for the benefit and the protection of the company's creditors**.

In particular, the capital maintenance rules preclude the company from returning capital directly or indirectly to the shareholders, unless the company is being wound up.

This doctrine is based on the premise that it would be pointless for a company, having raised its legal capital, to be free to conduct itself subsequently in total disregard for the legal procedures and requirements. These regulations and rules on capital serve to **protect the creditors from fraud and deceit** from the Company.

The Capital Maintenance Doctrine owes itself to the **English Case** referred to as ***Trevor vs Whitworth*** *(1887)*.

Essentially, a company bought back almost a quarter of its own shares. Subsequently, during liquidation of the said company, one shareholder applied to the court for the balance of amount owed to him after the buy-back. As is customary, when you have these test cases you do not always have conforming decision by the court.

In this instance, the court of appeal upheld the request by the shareholder thereby ordering that he be paid back all balances due after the buy-back. It transpired however, that on appeal again, the HOL reversed the judgement of the court of appeal and held that the buy-back was ultra vires the company and the HOL declared that the company could not purchase its own shares even though there was a provision to that affect in the Memorandum of Association since this would result in a reduction of capital.

The HOL denied the possibility of the company reducing its capital.

Lord Herschell stated.

***Capital is of course, liable to be spent or lost in carrying on the business of the company, but no part of it can be returned to a member as to take away from the fund to which the creditors have a right to look at as that out of which they are to be paid**. Persons who deal with and give credit to a limited company naturally rely upon the fact that the company is trading with a certain amount of capital paid as well as upon the responsibility of its members for the capital remaining at call, and are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out except in the legitimate course of business.*

Thus, this case held that creditors have a **legitimate expectation to believe that any money placed and funded** to the Company is **being utilised throughout ordinary course of business**. They also have the legitimate expectation to believe that this funding is being

maintained within the business and is not being abused of or misappropriated by the shareholders.

The Capital Maintenance is thus there to prevent the company from being liquidated. Essentially, there are basic rules on which this doctrine is built upon, with the main argument being that it would be pointless for a company having raised its legal capital to be free to conduct business in total disregard of its legal capital. **Brenda** makes the distinction between when a company is profitable and when it is wound up. When the latter is the case, there is a ranking of creditors. **The Capital Maintenance Doctrine serves to prevent the winding up of a company, in order to protect creditors from risking non-payment.**

A number of issues emanate from this doctrine, primarily stemming from the Company's freedom to utilise its assets and capital, along with its freedom to adjust its legal capital after first having raised it. It is important to understand the interplay between the principles at hand. It is fundamentally acknowledged that the Company is to first and foremost observe and respect the interest of its shareholders, and thus the question arises as to the extent to which a Company is to consider third party interests.

Creditors operate under the expectation that the amount of capital raised by shareholders will be maintained within the company, ensuring liquidity, and thus there emerged the **creditor protection mechanism**, created in order to safeguard this expectation. This mechanism became crucial with the advent of limited liability. Courts, recognising the potential vulnerability of creditors, emphasised this protection through cases such as ***Progress Property Co Ltd vs Moore***, which established that capital maintenance serves to prevent unfair actions by company members and prohibits the improper distribution of company capital. Transactions which violate this principle are deemed null, as held in ***rolled Steel Products (Holdings) Ltd vs British Steel Corporation***.

This doctrine has been criticised by authors such as **Paul Davis**, who says 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 the company."*

What reduction of contracting costs do they speak of?

If the minimum thresholds are included in the Companies Act then the subscribers to the M&As don't need to bargain between them as to what the initial subscription needs to be because it is predetermined by law and this means you do not need to negotiate between you so costs remain at a low.

What we are trying to comprehend is the interaction that exists between this doctrine of capital maintenance and the restriction to freedom.

The issue highlighted by jurists generally revolve around the question as to whether a Company is truly free to part with its assets. **Prof Muscat** argues that if the rule of capital maintenance had to be applied to all transactions, there would be the real danger that a company's value falls below that of its capital.

Having said that, there might be scenarios where a company is justified in reducing the value of its legal capital but the law itself would include certain requirements. These rules are encapsulated in Maltese Law in chapter 5 of the Maltese Companies Act entitled '*Maintenance of Share Capital and Class Rights'* the relevant provisions are Article 104-116 of the Companies Act. The Maltes Capital Maintenance rules are derived primarily from the English Company's legislation and the second EC Company law directive.

In practice, this doctrine prevents the return of capital, whether directly or indirectly, to the shareholders ahead of winding up. Our law contains rules on how these distributions and

adjustments can be carried out. Within the Companies Act, one finds articles 105-110, which pertain to this notion. These provisions may be categorised into 2 main groups, the first being those **rules relating to the payments for share capital** and which are designed to ensure that the company obtains the capital which it has claimed to raise, and the second being the **prohibition of the return of capital to shareholders.**

1.The first among these is the rule that there can be **no purchase by a company of its own shares.** Trevor Vs Whitworth reflected this and is now stated in Section 105 of the Maltese Companies Act.

This rule has been modified to allow for the redemption and purchase by a company of its own shares provided that the strict requirements at law are followed. The statutory scheme permitting in exceptional cases a buy-back are encapsulated in Articles 106 to 110 of the Companies Act.

2.The second rule under the second category is that **no reduction of Capital other than on the basis of a statutory scheme may be permitted** provided that it is also **confirmed by the court** so you have a double protection, a statutory scheme in terms of law which needs to be subsequently checked and confirmed by the court. This rule is reflected in the Maltese companies act in Article 83 of the said Companies Act.

3.A third rule is that a **company cannot provide financial assistance for the purchase of its own shares**. This notion of financial assistance is very important in company law and is strictly regulated by Article 110 of the Companies Act.

Prof. Muscat is critical of how certain aspects of these rules work in practise. He argues that the precise relationship of Art. 110 that deals with financial assistance with the doctrine of CM is debatable. This is because although he recognises that there is an element of creditor protection involved, the truth of the matter is that Art. 110 is more focused towards

addressing wider concerns such as the appropriate method of funding corporate acquisitions and share price manipulation

4.The final rule that emerges is that **no dividend is to be paid out of capital**. It ought to be called from profit and this rule emanates from the case in ***Re Exchange Banking Co*** or the ***Flitcroft Case.*** All shareholders have a right to dividends but a company can only distribute dividends out of profits and not out of the legal capital.

We have a set of rules which regulate and ensure that the legal capital is raised and a second set of rules which target and ensure the maintenance of the capital that is raised.

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.

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.

If the conditions are laid out for scenarios in 106 and 107, **108 provides us with what happens in the case of a breach**. In the sense that it regulates a circumstance where shares are acquired or held in contravention of Articles 106 and 107.

The central Article is 110. It is very important and deals with financial assistance where the EU takes it as very important and tries to regulate it as much as possible to ensure that there aren't any monopolies and ensure that there is proper funding when it comes to companies.

We must now discuss whether the current doctrine of capital maintenance can still subsist/ exist. Can it continue to exist on the grounds that it correctly predicts the result the

contracting parties would have arrived at, and this reduce transaction costs? It is argued that despite the significance which other financial facts about the company may have for the creditors – the companies act still considers the notion of share capital as being central for creditor protection.

Creditors are assisted by means of tools such as;

- Accounts
- Annual return submitted.

Rather than a historical figure in the shape of a figure, as a reaction the EU second directive **has updated the current position** and are targeted at reducing the restrictive nature of capital maintenance rules especially in the area of capital reduction.

There are serious doubts as to how valuable creditors think the capital maintenance doctrine is. The relationship between companies net assets to legal capital is by no means the only way of measuring the capital worthiness of a company because the truth of the matter is that there are far more accurate corporate documentation available that would provide them with the financial position of the company. Other measures including net assets, cash flow and interest cover are considerably more important.

Interestingly, in an exercise carried out in England by Company Law Commission confirmed that a majority of those consulted were of opinion that a company's share capital is nowadays relatively unimportant as a measure of its ability to repay credit.

Some argue that the modern challenge is to rationalise the current position into a more transparent and coherent body of rules intended to protect creditors. As a first step, it is suggested to move away from the confusing label of capital maintenance in favour of a **concept that highlights the fact that the objective is to have a body of rules which set constraints/restrictions on the unauthorised dissipation of assets**.

The CM rules operate to restrict the freedom of companies to adjust their share capital. Those rules as reinforced by the second directive are unduly restrictive and ought to be relaxed. CM is part and parcel with the notion of Share Capital. Share capital must be included in the

M&A's of the company. You have the requirements of authorised, issued, paid-up, and minimum authorised share capital. What we are saying is if we have a question we do not simply look at the rules of CM being Art. 104 et seq but also look at the M&A's.

Essentially, the trend is to completely reimagine the rules and instead of calling them CM to address them as rules against the unauthorised dissipation of assets.

Centralised Management in the LLC

Let us consider the scenario of a Sole Trader, whereby the trader is in total command of the running of the business. It is one individual who handles all the decision-making and day-to-day running of the business. We shall compare the sole trader with the scenario of a small number of individuals who come together to invest in a business in order to run a shop, for example. If there are just 3-6 individuals involved, they will probably all want to be involved in the running of the business in some way or another. They might not all want to be involved in the daily operations of the company, but they would want to be involved in the taking of important decisions. As long as the number is relatively limited, the direct involvement of these individual investors in the business which will be set up does not really create a practical problem. However, if the number of investors who try to get together to invest in a business runs into tens, hundreds, or even thousands, as happens with a LLC**. In this case, there is an immediate appreciation of the impracticality of vesting decision-making powers in all of these individuals directly.**

Therefore, one of the fundamental characteristics of the LLC which was developed in the 19th Century was to develop the notion of **Centralised Management**. Centralised Management means that where there is a large number of investors that there would be a small team of people who can manage and operate the business, taking the fundamental decisions in the interest of the larger body of investors - hence, the creation of the notion of the **Board of Directors**. We have referred to the 2 principal organs which administer the running of a company, being the **General Meeting**, run by Shareholders, and the **Board of Directors.** The General Meeting is the term used to refer to the collection of shareholders and investors, whereas the Board of Directors is that organ composed of Directors. The main difference between the General Meeting and the Board of Directors is that it is the board of directors which is responsible for the **management** and the **running** of the Company. This is what our company law regime provides for. This principle results from a provision in our Companies

Act, being **article 137 (3)**, which essentially states that the management of a Company is vested in the Directors.

137 (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.

The wording of this article indicates that when considering the powers of the directors, we must refer to both the Companies Act and the M&As.

Let us imagine that a Company operates the running of a Hotel. The business carried out involves day-to-day decisions, with some decisions being more important to other. When it comes to such decisions, which are taken on a weekly, daily, sometimes monthly, basis, the question arises as to which one of the two organs is to be responsible to take such decisions. The answer lies in **article 137(3)** of the Companies Act, keeping in mind the different provisions in the Companies Act and the different provisions in the M&A.

Article 137(3) says that the business of the company shall be **managed by the directors** who shall have **all the powers of the company except those** that are **by law** or **by the M&As** required to be exercised by the Company in the General Meeting.

Thus, the default position is that the Directors have all the powers of the Company, except where those powers and decisions are to be taken by the Shareholders, per the law and per the M&As. If the Company wishes to make amendments to the M&A, the Companies Act (art 79) holds that any alteration to the M&A of the Company requires an **extraordinary resolution** passed by the Company in **General Meetings**. Therefore, by way of article 137(3), the Directors have no power to amend the M&As.

On the other hand, if the Company wishes to appoint a CEO, since there is no provision in the

Companies Act which holds that this decision is to be taken by the Shareholders, then the decision is taken by the **Directors**, **unless the M&A holds that this decision is to be taken by the Shareholders**.

The M&A may state that such decision taken by the Directors must be approved by way of an

Ordinary Resolution by the Shareholders, which is particularly why the M&As play such a pivotal role in ascertaining who is the decision-maker.

In the case of a clash between the Law and the M&As, as a general rule, it is the Law which

prevails and applies. However, certain provisions in the Companies Act state that a particular rule shall apply **unless the M&As stipulate otherwise**, and thus one must carefully refer to the law in the case that the law and the M&As are not in agreement.

The Board of Directors may further delegate their powers to a **Manager** or a **CEO**, or a certain position of trust employed and empowered to take decisions on a daily basis. In this scenario, the Board of Directors are **delegating their powers**, and a **contract of mandate** is formulated, thus subjecting the manager and the Directors to the laws on mandate, with the manager serving as the mandatary and with the Directors serving as the mandator.

We may come across instances where the shareholders, in their stages of agreeing on the M&As, decide that they cannot allow the Board of Directors to purchase immovable property without referring to the Shareholders and seeking approval by the Shareholders. Thus, it may be, that there is a provision in the M&As which states that where it comes to the acquisition of an immovable, such decision will require the prior approval of the Shareholders in a General Meeting. Even there, the provision could take several forms - it could hold that a

decision relating to the acquisition of an immovable may require approval by way of an Ordinary Resolution (50% +1 of the Shareholder votes), or else, it may be that the provision may read that such acquisition of an immovable will require the unanimous consent of the Shareholders. Another twist is that the provision could read that the acquisition of an immovable for a consideration in excess of EUR1,000,000 will require a General Meeting Approval by way of Ordinary Resolution, and thus any acquisition in consideration of a sum below EUR1,000,000 may occur by the Directors without first having to seek approval.

The point being made is that when you require to ascertain who is responsible to take appropriate to take a particular decision, **per the rule stipulated by Article 137 (3)**, we must first assume that the Directors are vested all powers, then we must refer to the **provisions of the Companies Act**, and then we must refer to the **Memorandum and Articles of Association**, and where the Companies Act and M&As are silent on the matter (i.e - they do not state that such decision is to be taken by the Shareholders), then it is the Directors who may take that decision.

Directors

The Companies Act does not define the term directors, but rather it provides a description for directors;

"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;

Thus, even if a person is not formally appointed a director, there may be circumstances whereby such person will be considered as a director for the company, for the purposes of the Companies Act. Thus, if a person is performing activities substantially similar to the activities performed by directors, he will be considered a director. So, if someone is running a company behind the scenes, he is to be considered a director.

For the purposes of our law who is a director of a company can be one of 2.

1. A person whose name is listed in the memorandum, as he has been formally appointed.

2.Any person who is performing the functions of a director even if his name doesn't appear on the memorandum is also a director.

The question arises as to whether a company may take the form of a director. Although directors are normally natural persons, it is possible to have a **corporate director**. Directors may be divided into 3 principal categories:

1. **Executive vs Non-Executive:** One must distinguish between **executive** and **non-executive directors**. The latter are not involved in the day-to-day running of the company, and are not as involved as executive directors. They have what is normally called a supervisory and advisory role. This distinction is **not made in the Companies Act**. This distinction is something which has been created by commentators of Company Law. However, if you have a look at the First Schedule to the Companies Act, there are 3 provisions that make a distinction between directors who hold executive office and directors who do not hold executive office, being articles **67, 69,** and **70.** To this end we can refer to ***Police vs Angelo Xuereb*** *(Criminal Court, 17th July 2001)* and ***Dr Andrew Borg Cardona vs Victor Zammit*** *(CoA, 14th May 2010,)*. We will read that the responsibility / lack of responsibility of these different types of directors will not be applicable to the special laws relating to VAT, Income Tax, and Social Security - here this distinction does not exist.

Dr Andrew Borg Cardona vs Victor Zammit

CoA, 14th May 2010

Lanqas ma jista' direttur jahrab mir-responsabbilta` tieghu bl-iskuza li hu kien *minority* shareholder jew non-executive director. Direttur, anke jekk *non-executive* jew minoritarju ghandu l-istess responsabbilta` bhad-diretturi l-ohra u ghandu l-obbligu li jkun jaf u jimpenja ruhu li jwettaq id-doveri mposti fuqu mil-ligi. Kif jghid il-Professor Andrew Keay, *"Today it is* very difficult for a director to argue that he was not a party to the carrying on of the business of the company (unless such director registers a dissenting opinion), especially since it is one of the duties of directors to actually participate in the business of the company".

Il-Pulizija vs Angelo Xuereb

Criminal Court, 17th July 2001

The court case addressed the liability of executive and non-executive directors in a company regarding involuntary homicide charges arising from a workplace accident.

Executive directors, such as Angelo Xuereb, were found to have a direct role in the company's daily management and decision-making. They are responsible for ensuring compliance with laws and regulations, including health and safety measures. The court acknowledged that Xuereb had established a professional structure within the company, with middle management overseeing daily operations, implemented safety committees, ensured staff training, and maintained systems to monitor compliance. Despite these measures, an accident occurred, but the court determined that Xuereb had exercised the necessary diligence and could NOT be held criminally liable.

Non-executive directors, including John A. Gauci and Joseph Ellul Vincenti, were **recognised as not being involved in the company's daily operations**. Their **responsibilities were limited to attending board meetings**, p**roviding governance oversight**, and **ensuring compliance with general policies**. They **did not engage in operational decisions or the employment of staff**. The **court found no evidence of negligence or failure to exercise reasonable diligence in their supervisory roles**. Both non-executive directors were deemed to have relied appropriately on the company's internal safety policies and professional structures.

The **court emphasised the necessity of a causal connection between a director's actions or omissions and the occurrence of the event to establish liability**. **Directors can only be held responsible if it is proven that they had knowledge of the wrongdoing or failed to exercise due diligence to prevent it, and if their actions or omissions directly contributed to the incident**. In this case, the court concluded that the directors had implemented sufficient safety structures and

measures. It further found that the victim's own actions were a significant contributing factor to the accident. Consequently, all the directors were acquitted of the charges.

Again, one should mention that this distinction is not found in the Companies Act, but rather in the first schedule to it, being the model and default Articles of Association, in Articles 69-71;

69. A managing director or director holding any other executive office shall receive such remuneration as the directors, subject to the approval of the company in general meeting, may from time to time determine.

70. The directors may delegate to any managing director, or to **any director holding any other executive office**, any of the powers exercisable by them upon such terms and conditions and with such restrictions as they may think fit, and either collaterally with or to the exclusion of their own powers and may from time to time revoke, withdraw or vary any of such powers."

71. The directors may also appoint a committee consisting of one of more persons selected from among themselves delegating to it any of their powers. Any such delegation may be made subject to any condition or requirement as the directors may impose and may be made either collaterally with or to the exclusion of their own powers, and the directors may from time to time revoke, withdraw, alter or vary all or any of such powers. Any such committee shall, subject to any of the said conditions or requirements, regulate its own proceedings, in so far as possible in like manner as if its meetings were meetings of the directors."

2. **De Jure vs De Facto**: De jure directors are those who are formally appointed and listed on the M&As whereas de facto directors are those who are not formally appointed but who instead are performing functions substantially similar to the functions of directors. One may also have a shadow director, whereby a person is involved in the running of a company but who is not formally appointed on the Board. **Article 251 of the U.K. Companies Act (2006)** contains a reference to shadow directors, stating that a *"shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.* Maltese

Law does not make reference to shadow directors. Maltese Law prohibits directors who are over the age of 61 to receive pension, and thus the notion of shadow directors plays a very useful role for senior directors approaching this age. Insofar as the distinction between de jure and de facto directors go, we refer to ***Joseph u Monica Grima vs Pierre Buontempo*** *(19th May 2014).*

Joseph u Monica Grima vs Pierre Buontempo

Court of Appeal 14th May 2014

Kif tgħid l-awtriċi Hannigan (*ibid.* paġna 845), "*the* Courts are not prepared to accept that it is possible for a director to have no functions for these purposes", jiġifieri, biex jiġu protetti l-interessi tal-krediturі. Ir-responsabilita' hija tad-diretturi *de iure* u mhux biss fuq dawk *de facto.* Id-diretturi, speċjalment meta ikun hemm kummerċ bi frodi, għandhom jitqiesu responsabbli *in solidum* għal dak li seħħ minn kull wieħed minnhom, u ma jistgħux jaħarbu mir-responsabilità billi jgħidu li peress li ma kinux ġew ippubblikati *l-accounts*, huma ma kinux a konoxxenza tal-vera sitwazzjoni.

Hannigan: "Essentially, a de facto director is someone who is part of the corporate governing structure of the company and who has assumed the status and functions of a company director so as to make himself liable as if he were a de jure director. It is possible, for example, for a shareholder or a consultant to the company to act in a way which makes him a de facto director. But he must have assumed the office of director and it is necessary to distinguish between a person acting in another capacity, for example as a mere agent, employee or adviser of the company or solely as a shareholder protecting his investment. If it is unclear whether the acts of the person in question are referable to an assumed directorship or to some other capacity, the person in question is entitled to the benefit of the doubt.

The question whether someone is a de facto director is likely to arise where a penalty or liability may be imposed on a `director`, such as disqualification or liability for wrongful trading or misfeasance and the individual attempts to evade the penalty or liability by relying on the fact that he is not a de jure director, i.e. not a formally and properly appointed director. The Supreme Court confirmed ***in Re Paycheck Services 3 Ltd, Revenue and Customs Commissioners v Holland*** that there is no single decisive test for determining whether someone is a de facto director, and indeed it

is not necessary that the term `de facto director` be given the same meaning in all of the different contexts in which a director may be liable.

…

In Re Idessa Ltd, Burke v Morrison an individual who exercised real influence over the company` s affairs and acted on an equal footing with the de jure director and who had the same salary and access to the company`s bank account, financial records and payroll functions as the de jure director, and who was held out as a director in the company`s business plan, could fairly be regarded as part of the company's corporate governance, however much he downplayed his role when giving evidence, and he was liable as a de facto director. In ***Re Mumtaz Properties Ltd, Wetton v Ahmed*** a person who, within an informally run family business, dealt with suppliers and local authorities, who had a director's loan account on which he could make drawings for his personal benefit, and who the court found to be one of the nerve centres from which the company`s activities radiated, was a de facto director. He was part of the corporate governance structure of the company and was jointly and severally liable with the other directors for the misapplication of the company`s funds."

Kif qal Park J. fil-każ ***Re Continental Assurance Co. of London plc*** deċiża fl-Ingilterra fl-2001 (All ER (D)229, Ch.D):

""… in my view, [the directors] would have been expected to be intelligent laymen. They would need to have a knowledge of what the basic accounting principles for an insurance company were … They would be expected to be able to look at the company's accounts and, with the guidance which they could reasonably expect to be available from the finance director and the auditors, to understand them. They would be expected to be able to participate in a discussion of the accounts, and to ask intelligent questions of the finance director and the auditors. What I do not accept is that they could have been expected to show the sort of intricate appreciation of recondite accounting details possessed by a specialist in the field ….."

"Fir-rigward tar-responsabbiltà personali tad-direttur Pierre Buontempo, huwa ċar li meta jkun hemm aġir bi frode jkun hemm lok għal-lifting the corporate veil. Fil-ktieb **Boyle** & **Birds**' **Company Law** (*7th Edit. 2009* paġna 62), l-awturi jgħidu li:

"It is well established that the courts will not allow the corporate forms to be used for the purposes of fraud, or as a device to evade a contractual or other legal obligation."

Article 251 of the UK Companies Act 2006 provides a definition of a shadow director, akin to our understanding of alternate directors, which is;

"*a person in accordance with whose directions or instructions the directors of a company are accustomed to act*." This means that a shadow director is not officially appointed as a director but still exerts significant influence over the company's affairs.

The notion of shadow director is interpreted as forming a part of our understanding of directors.

This **influence is typically in the form of providing directions that the board of directors follows regularly**, even though the individual does not hold a formal title or publicly engage in the management of the company. While the Maltese Companies Act does not specifically mention shadow directors, the UK law offers a clear framework that **holds shadow directors to the same responsibilities and liabilities as formally appointed directors**. This means they can be legally accountable for company decisions, including potential financial liabilities or misconduct. An example of a shadow director could include a majority shareholder who regularly directs the company's strategic decisions or an advisor whose recommendations the board consistently follows. Despite not having a formal role, such an individual could face similar legal responsibilities as a de iure director.

GBCom Ltd vs Vella Falzon pro et noe *- shadow directors, de iure, de facto directors*

30th November 2020

Persuna tista` titqies li hija "*direttur*" ghall-finijiet u effetti kollha tal-ligi, jekk tkun *tmexxi* kumpannija, anke jekk tkun tissejjah *manager.* Ghalhekk fis-sustanza, li jghodd mhuwiex it-titolu jew l-isem tal-kariga li jkollha persuna, izda l-funzjoni dirigenzjali fis-sens tat-tmexxija li l-persuna jkollha fil-kumpannija.

Fil-kuntest Malti, direttur jassumi l-funzjoni *de jure* meta jkun formalment u validament mahtur skont il-ligi u registrat mar-Registratur tal-Kumpanniji. Fl-Ingilterra kienet trattata fid-dottruna u fil-gurisprudenza l-figura ta` diretturi : *de facto* u *shadow directors* (dawn tal-ahhar b`referenza specifika ghalihom f`Sec 250 tal-Companies Act 2006).

Fil-kaz In **Re Hydrodam (Corby) Ltd, Millett J.** jiddeskrivi d-diretturi *de facto* hekk : "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 probably 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 probably be performed by a manager below board level. A de facto director, I repeat, in one who claims to act and purports to act as a director, although not validly appointed as such.

3. Alternate Directors: an alternate director is a person who is appointed by another director to act instead of that director at a particular meeting or meetings of the company. It is similar to the appointment of a mandatary. You cannot have an alternate director unless the Articles of Association specifically authorise you to appoint an alternate director. A possible use of alternate directors would include situations whereby a director would be abroad, for instance.

Appointment of Directors

Once again, we must look at what the Memorandum and Articles of Association says about the appointment of directors, because one set of M&As may provide for a different method of appointment of directors than another set of M&As. Thus, we will refer to the **typical rules for the Appointment of Directors**.

The point of Time when the Company is Registered

When the company is registered, a set of M&As **need to be filed with the Registrar of Companies**. In that first set of M&As, **per article 69 (g)**, the **names and addresses** of the **first directors** must be stipulated in the M&As.

69 (*g*) the number of the directors, the name and residence of the first directors and, where any of the directors is a body corporate, the name and registered or principal office of the body corporate, the manner in which the representation of the company is to be exercised, and the name of the first person or persons vested with such representation;

Subsequent Directors

Here, there are **2 basic forms / methods** of appointment of directors. This does not mean that these are the only 2 methods which are permitted vis-a-vis the appointment of directors, because much of the M&A of the Company can be contracted in and out of, in that the M&A is a contractual document, and thus the subscribers to the M&A (shareholders) are free to determine any method of appointment as they deem fit. Notwithstanding this, the 2 most common ways of appointment are;

1)When directors are initially appointed, they will then need to retire at the end of the next AGM (annual general meeting), and that during that next AGM, new directors shall be appointed by means of an **Ordinary Resolution** (50% +1 of Shareholder votes). Thus, if there are 10 shareholders each holding 10% of the Share Capital in the Company, and in the original M&A, there were 3 directors who were appointed. The articles could provide, as per this first method, that the first AGM which is to be held will result in the retirement of the incumbent directors, and by means of an Ordinary Resolution, new directors shall be appointed. Another point to make is that it is usually provided that a retiring director will be able to be reappointed at the next AGM where the voting takes place. This scenario occurs in many companies.

2) **When directors are appointed by way of different Classes of Shares**. This method is used quite a lot in Malta, with a significant portion of Companies adopting this method of appointment for directors. One must note that in a number of cases, the share capital is divided into different classes of shares. Here, we are not referring to the distinction which we had made between ordinary shares and preference shares, **but rather situations where the Share Capital is all comprised of Ordinary Shares** which are subsequently divided into different classes (i.e - Class A shares, Class B shares, etc). In this method, Class A shares will have the right to appoint 2 Directors, Class B Shares will have the right to appoint another 2 directors, and Class C shares will have the right to appoint 1 director, for example, all contingent on the Memorandum of Articles. In ***Scottish Cooperative Wholesale Society Limited vs Mayer*** (1959), the House of Lords held that if a director is appointed by a class of shares, **he represents the entirety of the Company, and not those shareholder classes that appointed him.**

In the latter method, directors are **bound to act in the best interest of the Company**, and thus it is irrelevant as to which Class of Shares appointed which director, for all directors are to act in the best interest of the Company, i.e the **whole body of shareholders**.

With regards to the second method of appointment, we should refer to **Article 139(4) of the Companies Act**;

> **139. (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 association, directors are usually appointed by forms of elections, owing to the hundreds if not thousands of shareholders. With the notice of the next AGM, every shareholder must attach a proxy. In the larger corporations, a notice will be sent along with a proxy form, and usually shareholders do not attend in person but rather fill out the proxy form to vote on the appointment of directors.

If the articles of association state nothing, the directors hold office from one general meeting to another where they are eligible for reappointment and if they are not removed at the meeting, they are automatically reappointed. A large exception to the rule is **casual vacancies**. Halfway through the term the director might resign, die. When there is one the vacancy is filled by the remaining directors unless otherwise provided in the memorandum of association. Article 140 details the procedure of filling this seat up.

140 (6) (*a*) Unless otherwise provided in the memorandum or articles of a company, a casual vacancy may be filled by the continuing director or directors, and without prejudice to the aforesaid powers of the directors, it may be filled by the company in general meeting.

(*b*) A person appointed by the directors to fill a casual vacancy shall hold office until the next following annual general meeting and shall be eligible for re- election, but shall not be taken into account in determining the directors who are to retire by rotation at that meeting.

(*c*) A person appointed to fill a casual vacancy by the company in general meeting shall be treated, for the purpose of determining the time at which he or any other director is to retire, as if he had become director on the day on which the person in whose place he is appointed was last appointed director.

In the case of **Pulizija vs Tonio Ciantar**, the court stated that if a company has **not** filed its VAT or social security, that is considered to be a **continuous offence,** therefore, once one becomes a director in the case of continuous offences, they could still be held liable, this thus places an extra burden on potential directors to ensure that the company has its affairs running smoothly.

There may also be the requirement of a share qualification, in that in order to qualify to serve as a director of a company, such person must possess shares within that company, in order to ensure that no outsiders will enter into a company. This scenario will **only exist if the Articles so provide - otherwise, it will not exist**.

This is catered for in **articles 139 (2);**

139 (2) Without prejudice to the provisions of sub-article (1), where a director is by the memorandum or articles of a company required to hold a specified share qualification, he shall either sign the memorandum for a number of shares not less than his qualification or sign and deliver to the Registrar

for registration an undertaking in writing to take from the company and pay for his qualification shares:

Provided that he shall vacate his office if he fails to obtain his qualification within two months after his appointment, or such shorter time as may be fixed by the memorandum or articles, or if at any time thereafter he ceases to hold his qualification; and he shall be incapable of being re-appointed director of the company until he has obtained his qualification.

Article 146 provides for the company's submission of a **Form K** in the case of a change of directorship;

146. (1) Every company shall send to the Registrar for registration a return of any change among its directors, or company secretary or in the representation of the company, specifying the date of the change, together with the name and residence or name, registered office and registration number, as the case may be, of any new director or company secretary, within fourteen days from the happening thereof:

Provided that the Registrar may, before registering the return, take such steps and require such information as he may deem necessary to ascertain the correctness of the return and to determine whether the provisions of this Act have been complied with.

(2) 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.

Until very recently, we had this anomaly in the case of private companies that one could go and register a new company and put one's name as a director of the company, with such person not even being aware that he is being appointed as a director of that company. This has been done away with, because now, when a private company is incorporated, the directors must give his consent that he is going to act as a director for the company. The problem today with incorporation pertains to the

registered office, since a company may be incorporated establishing the residence of one of the directors as the address of the company, without such director even knowing that his home is being used as the registered office of the company.

Amount of Directors

In a public company, the **minimum number of directors is that of 2,** while in the case of private companies, **the minimum number of directors is that of 1**.

137. (1) Every public company shall have at least two directors.

(2) Every private company shall have at least one director, and where a private company has one director, all references in this Act to two or more directors shall be construed as references to such one director.

139. (1) A person shall not be capable of being appointed director of a company **unless he has personally signed the memorandum indicating his consent** to act as a director or has otherwise signed and delivered to the Registrar for registration a consent in writing to act as such director.

If there is only 1 director in the company, that person cannot also be the company secretary, per **article 138 (2), with the only exemption being that of a private exempt company, which is defined in section 211 of this same act**.

138. (1) Every company shall have a company secretary.

(2) No company shall:

(*a*) have as company secretary its sole director;

(*b*) have as sole director of the company a body corporate the sole director of which is company secretary to the company.

(*c*) have as company secretary a body corporate, unless such body corporate is duly registered as a company service provider in terms of the Company Service Providers Act:

Provided that, for the purposes of this paragraph, a body corporate which does not require registration in terms of article 3(1)(*a*) and (*b*) of the Company Service Providers Act may also act as a company

secretary in terms of this article.

Directors may also be liable criminally if certain provisions of the criminal law are breached.

This is pretty much a high risk situation for directors of any type of company. There are various laws on out statute books that contain provisions that if particular provisions of those laws are breached, then a breach of those provisions will give rise to a criminal offence and there are literally tens of these laws, such as the Criminal Code, Code of Police laws. Then there are special laws such as laws regulating planning, tax, health and safety etc. When going through these laws, one will realise that there are certain provisions that impose duties, that if those duties are breached, there is a criminal law liability. The problem is that in these laws, but also in another law which is called the Interpretation Act (§975), there are provision that **the net effect of them will be that if any of these laws are breached and the breach thereof gives rise to criminal liability, then, any director of the company that would have breached that law, becomes criminally, personally, liable for that breach unless that person proves that he/she did not know of the commission of the offence and he/she had taken every reasonable step to prevent the commission of the offenc**e. This regime has given rise to quite a number of scenarios, where directors have become personally liable for the breach of the criminal law with serious repercussion including heavy fines, tainted police conduct certificate etc. One particular set of circumstances in which this principle of criminal liability arises in practice is in **occupational health and safety** legislation, has lots of rules, many of them included in subsidiary legislation that are aimed rightly so at protecting the health and safety of people at work. But there are provisions that if certain of these rules are breached, then the person involved in the running of the company can be liable because who was the director at the time when the crime was committed, will be held liable – which is an article that is found under the Interpretation Act.

Qualifications of Directors

The law does not have any required qualifications for the appointment, but rather it provides for certain disqualifications for directors;

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;

…

(*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.

An **undischarged bankrupt** is one who applies for bankruptcy but, notwithstanding his application, the Court is not satisfied that his bankruptcy was not a ***bona fide bankruptcy,*** and thus has not yet concluded whether the claimant is to be declared bankrupt or not. The huge advantage of a trader apart from the fact that the commercial code regime is applicable to you there is also an escape route to you that is not available to a normal person, that if you are a trader you can go to the courts file an application and your trade books and if the court sees you are a bona fide trader with a. bona fide bankruptcy, all your debts will be forgiven and you will start afresh.

Article 142 (1) (d) refers to article 320, which in turn refers to a decision given by the Court, upon the application of the Attorney General, that if any person is found guilty under the Companies Act other than offences punishable only by a fine, then he is unable to act as a director, unless he falls under the exemptions under the proviso. Another situation under article 320, pertaining to **disqualification orders**, relates to **fraudulent trading** and **wrongful trading**, in which case the Court may order him to contribute to the assets of the company to make good for any shortfalls that there are. If a person is ordered to contribute to the assets to the company, then he is subject to a disqualification order in terms of article 320.

We should also refer to **article 142 (6)**;

(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.

Let us imagine that one wants to become a director of a company in Malta but he has a disqualification order from a Court decision in Greece. In this case, one cannot be come a director in Malta, because of **article 142(6)**, which holds that the disqualification order issued in another EU Member State is directly applicable in Malta, as explored in ***Dr Kevin Dingli vs Dr Joseph Bonnici.***

The question arises; **should directors be qualified to act as such**. The law **does not require directors to have any particular qualification**. This is the general principle. If the director is the director of a regulated entity, then those directors will need to have been approved by the regulator before taking up their appointment - to this end, the MFSA will delve into the details of the person concerned, and unless the individual is regarded as being capable to act as a director in that particular field, the MFSA will not grant its authorisation for such person to act as a director. One of the factors considered by the MFSA is the experience and qualifications, and thus qualifications do come into play in cases of highly regulated sectors. However, in cases of general Companies (i.e - companies which are not regulated), the law does not require any qualification for such directors to be appointed. There can also be a court order to remove a director.

An argument could be made that considering the duties imposed upon the director, as well as the severe consequences which follow the breach of such duties, that the directors should require some sort of qualification. This has been debated amongst jurists, with the conclusion being that **the legislator cannot impose any restrictions or qualifications on the director to be appointed, because otherwise, the entrepreneurial sector will dampen significantly, eliminating many companies which operate with directors of no qualifications**.

Prof Muscat argues that the legislator should adopt a middle-ground position, in that the law should not require any qualification on the directors, but rather that **any person who wishes to be a director on a Company ought to follow at least a relatively brief course on Directors' Duties and the functioning of a Company**. This is because regrettably, there are many directors who have absolutely no clue as to what their duties are. This approach serves to remediate the two extreme positions, in that the director will be somewhat versed in his duties and powers as a director, without having to be formally qualified to serve as a director.

Termination of Directorship

1) **Expiry of the term of office** - if a director is appointed for a fixed period of time, and this period expires, then he ceases to be a director.

2) **Resignation** - if a director does not like the way things are being managed, he is expected to resign.

3) Upon Death - directorship is not inherited, and thus upon the death, a vacancy arises.

4) Disqualification Orders per article 320 and 142.

5) Removal - one is removed as a director by virtue of **article 140** of the Companies Act, which holds that a simple majority at a General Meeting can remove one from being a director. If the M&As stipulate otherwise, it is **article 140 which prevails, and not the M&As**. Article 140 is applicable ***notwithstanding anything contained in the M&As***.

140. (1) A company may remove a director before the expiration of his period of office by a resolution taken at a general meeting of the company and passed by a member or members having the right to attend and vote, holding in the aggregate shares entitling the holder or holders thereof to more than fifty per cent of the voting rights attached to shares represented and entitled to vote at the meeting. (2) The provisions of sub-article (1) shall apply notwithstanding anything in the company's memorandum or articles or in any agreement between it and the director.

6) Court orders - if a Court order stops one from acting as a director, such director is to be removed.

Therefore, the M&A cannot entrench a director's position, as 50%+1 can always **remove** a director, even if there are share class rights. A director must have the opportunity to be heard before being voted out. If one does not have sufficient votes to remove a director, one can go to court as they have the power to **remove a director.**

Duties of Directors

A preliminary point is that **directors are duty bound to the company, and not to shareholders,** as established in the English Case ***Percival vs Wright*** *(1902)* and in the Maltese Case ***Charles Sant Fournier vs Philip Attard Montalto*** *(7th November 2001).* The only cases where directors will owe duties to shareholders is in cases of mergers or acquisitions, as held in ***Herald International vs Grait*** *(1993)* or in an insolvency situation, whereby directors owe duties also to creditors, to ensure that creditors will not be prejudiced by their decisions.

Percival vs Wright

1902

"The directors of a company are not trustees for individual shareholders, and may purchase their shares without disclosing pending negotiations for the sale of the company`s undertaking."

The apparently unqualified width of the ruling has, over the course of the last century, been subjected to increasing judicial, academic and professional critical comment; but few would doubt that , as a general rule**, it is important for the well being of a company** (and of the wider commercial community) **that directors are not over-exposed to the risk of multiple legal actions by dissenting minority shareholders**. As in the affairs of society, so in the affairs of companies, rule by litigation is not to be equated with the rule of law.

For his part, Lord Grabiner QC accepted that the fiduciary duties owed by the directors to the company do not necessarily preclude, in special circumstances, the co-existence of additional duties

owed by the directors to the shareholders. In such cases individual shareholders may bring a direct action, as distinct from a derivative action, against the directors for breach of fiduciary duty.

A duality of duties may exist. In **Stein v. Blake** [1998] 1 All ER 724 at 727d and 729g Millett LJ recognised that there may be special circumstances in which a fiduciary duty is owed by a director to a shareholder personally and in which breach of such a duty has caused loss to him directly (e.g. by being induced by a director to part with his shares in the company at an undervalue), as distinct from loss sustained by him by a diminution in the value of his shares (e.g. by reason of the misappropriation by a director of the company`s assets), for which he (as distinct from the company) would not have a cause of action against the director personally.

The fiduciary duties owed to the company arise from the legal relationship between the directors and the company directed and controlled by them. The fiduciary duties owed to the shareholders do not arise from that legal relationship. They are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case. Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities , which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders.

There may be certain remote instances where directors owe duties to the shareholders, but these are remote. When there is a takeover bid like HSBC. Over here the directors owe a duty to shareholders and not to the company itself that shareholders get a maximum return on their investment. When the company is veering towards insolvency the directors owe a duty to the creditors so that they are not prejudiced.

We will look into 4 different classifications of Director Duties, each regulated by different pieces of legislation and which carry different consequences when breached. These 4 categories are;

1) The **General Duties** of Directors arising out of the Companies Act and out of Civil Law;

2) The **Administrative Duties** of Directors which often but not exclusively arise out of the Companies Act;

3) Duties which result in **Criminal Liability** if breached by Directors; and

4) Duties which are **specialised** and pertain to Directors of certain **Regulated Institutions**.

We will start with the lastly mentioned duties, for expedition purposes. Those Directors which have

specialised duties are tasked with certain duties **over and above** the duties enlisted in the Companies Act. In particular, we are referring to 4 particular entities which are regulated by the MFSA, being 1) directors of **credit institutions** and **financial institution**, 2) directors of **insurance companies**, 3) directors regulated by **investment services law,** and 4) directors of Companies whose shares or bonds are listed on the **stock exchange**. In these cases, the directors will have additional obligations imposed upon them which emanate from the **Capital Market Rules**. We will not delve into these particular duties, but it is nonetheless important to note that directors of these regulated entities have much more on their plate when compared with the duties of the ordinary directors.

With regards to the duties a breach of which will result in **criminal liability**, we refer to **Competition Law**, **Data Protection Law, Planning Law, Tax Law, Health and Safety Laws**, etc. When one goes through these laws, we will realise that there will be certain provisions which impose duties which result in serious criminal consequences in the case that such duties are breached. The problem is that these laws, but also in another law referred to as the **Interpretation Act**, tend to work **against the director**, and **tend to shift the burden of proof onto the director to prove that he or she was not aware of the criminal activities going on within the Company.** There have been cases where the Directors were found **personally liable** for breaching such duties, resulting in consequences such as heavy fines and criminal sanction. One particular area to be noted in this regard is the legislation pertaining to **Optimal Health and Safety**, which contain several rules which are aimed, rightly so, to protect the health and safety of people at work. There are also provisions that state that if such rules are breached, then the person involved in the running of the business can be found liable.

Furthermore, as held in ***Andrew Borg Cardona noe vs Price Club Holdings Limited et***, the directors **may be required to act in the interest of third parties**, especially when the financial situation of the company compels such directors to act in consideration of such creditors. To this end, in ***Maltacom plc vs Mark Gaffarena,*** the Court imposed liability on directors because they acted in total disregard of the interests of the company's creditors. They had a duty towards the creditors to give a clear picture of the financial position to enable the creditors to take an informed decision about their dealings with the company.

Now, we will shift our focus to the 2 principal categories of duties of Directors, being those of a **general nature,** arising from the Companies Act and from Civil Law, and those of an **administrative nature.**

Duties of a General Nature

Here, we must refer to **Article 136A**, which was not found in the original drafting of the Companies Act. This Article was added to enlist the **general duties** of the Director which are to be followed by all directors, independently of any specialised rules which operate over and above these general duties.

136A. (1) A director of a company shall be **bound to act honestly and in good faith in the best interests of the company.**

(2) The directors of a company **shall promote the well-being of the company** and shall be responsible for:

(*a*) the general governance of the company and its proper administration and management; and

(*b*) the general supervision of its affairs.

(3) In particular, but without prejudice to any other duty assigned to the directors of a company, or to any one of them, by the memorandum or articles of association or by this Act or any other law, the directors of a company shall:

(*a*) **be obliged to exercise the degree of care, diligence and skill which would be exercised by a reasonably diligent** person having both -

(i)the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and

(ii)the knowledge, skill and experience that the director has;

(*b*) **not make secret or personal profits from their position without the consent of the company**, **nor make personal gain from confidential company information**;

(*c*) ensure that their **personal interests do not conflict with the interests of the company**;

(*d*) not use any **property, information or opportunity of the company for their own or anyone else's benefit, nor obtain benefit in any other way in connection with the exercise of their**

powers, except with the consent of the company in general meeting or except as permitted by the company's memorandum or articles of association;

(*e*) **exercise the powers they have for the purposes for which the powers were conferred** and shall not misuse such powers.

There is a **general duty for the Directors to Act in Good Faith and in the Best Interest of the Company**. This encapsulates the duty of a director. There is also a **general duty of loyalty**, in that the Director is not to put himself in a position of a conflict of interest, especially in a small market such as Malta. The directors must also use their powers for the purposes for which those powers were granted and not for any other purpose.

There is an overlap between the fiduciary duties of 1124A and the duty which exists under 136A of the companies act.

Anthony Caruana ltd vs Chris Caruana, Vascas limited vs Ellul.

In these 2 cases it dealt with breach of fiduciary duties on the part of the manager of the company but our court in both cases held that in the case of a director of a company the fiduciary duty is absolute but in the case of a manager it is not so absolute.

There is a risk where a Director may be faced with a decision which may affect the Director on a personal level, resulting in a conflict of interest. Let us imagine a Company (A Limited) run by 3 directors (X, Y, Z). X is also a majority shareholder of a totally different Company (Z Limited). Let us imagine that A Limited is a Company which develops software. The CEO of Z Limited may, at some stage, come up with a proposal which states that they must expand and seek companies which develop software in order to expand their business. **If A Limited is suggested as a company to be sought out by Z Limited, then X must declare his conflict of interest to the other Shareholders**.

The difficulty arises as to whether A Limited should be automatically excluded from this tendering

process due to this conflict of interest. Further, a question arises as to whether X should be excluded from the debate and from voting on the matter. **The answer is that it depends on what the Memorandum and Articles of Association provides.** The M&A often provides that if there is a Conflict of Interest, the Director is to declare his conflict of interest in the transaction or matter. The M&A will often state that such conflicted directors may not vote on the matter. Notwithstanding this, if X duly abstains himself from the voting, as per the M&A, then it is still possible for Z Limited to seek A Limited for their affairs, **unless the M&A contains a provision which holds that the Company may not enter into a contract with a third party with whom conflict of interest arises**. Again, this is subject to the M&A.

136A (3)(*c*) ensure that their personal interests do not conflict with the interests of the company;

Another **duty of loyalty** which arises is the **non-profit rule**, in that a **Director cannot, without the consent of the Company, make any personal profit out of his position in the Company.** This is enshrined in **article 136A (3)(b)**;

136A (3)(*b*) not make secret or personal profits from their position without the consent of the company, nor make personal gain from confidential company information;

Another particular duty is **article 143;**

143. (1) A director of a company **may not, in competition with the company and without the approval of the same company given at a general meeting, carry on business on his own account or on account of others, nor may he be a partner with unlimited liability in another partnership** or a **director of a company which is in competition with that company**.

(2) Where a director acts in violation of the prohibition contained in this article, the company may, at its option, **either take action for damages and interest against him or demand payment of any profits** made by him in contravention of this article.

(3) The provisions of this article shall be without prejudice to any other remedy which a company may have against a director for breach of duty.

This provision envisages 3 scenarios; 1) Compete with the company for his own account or for someone else. 2) Director is a partner with unlimited liability in a commercial partnership that is in competition with the company. 3) Most commonly arises in practice; the director cannot be a director on 2 companies in competition with each other, here consent is required from both companies.

Another particular duty is **article 145.**

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

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

Another duty is that of **article 144;**

144. (1) It shall not be lawful for a company -

(*a*)to make a loan to any person who is its director or a director of its parent company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person:

Provided that nothing in this paragraph shall apply either –

(i) to anything done, **with the approval of the company given at a general meeting**, to provide any such person as aforesaid with funds **to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company**; or

(ii) **in the case of a company whose ordinary business includes the lending of money or the giving of guarantees** in connection with loans made by other persons, to anything done by the company in the ordinary course of that business;

(*b*) to make to any director of the company **any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office**, without particulars with respect to the proposed payment, including the amount thereof, being disclosed to members of the company and the proposal being approved by the company in general meeting.

(2) For the purposes of this article, the expression "director" shall include any person in accordance with whose directives or instructions the directors of a company are accustomed to act.

One should note that as **per article 147**, the liability of directors is ***joint and several***;

147. (1) The personal liability of the directors in damages for any breach of duty shall be joint and several:

Provided that where a particular duty has been entrusted to one or more of the directors, only such director or directors shall be liable in damages.

(2) A director shall not be liable for the acts of his co-directors if he proves either -

(*a*) **that he did not know** of the breach of duty before or at the time of its occurrence and that **on becoming aware of it after its occurrence he signified forthwith to the co-directors his dissent in writing**; or

(*b*) that, knowing that the co-directors intended to commit a breach of duty, he **took all reasonable steps to prevent it.**

A director, per article 147(2) is free from liability only if he proves that he did not know of the breach of duty at the time of occurrence or else if he proves that he took all reasonable steps to prevent such acts which generate liability. If one did not know of the breaches, it is easier, since all

he has to do to exonerate himself from liability is to express dissent in writing upon his finding out. However, if he knew that the breach was being committed, he is duty bound to report and to take all steps to prevent it.

Pulizija vs Martin Pillow

[CA][2011]

Occupational health and safety; the defendant was the managing director of Pillow Frames Limited. The company was hired to do construction works. Throughout which, scaffolding was erected, and an employee of another company was on the scaffolding, an incident happened, and the employee was seriously injured. The Article 13 of Cap 249 deemed him guilty and personally liability.

Pulizija vs Dr George Cassar

[CM][30/04/2003]

Food health and safety; a company that owned and operated a hotel. The defendant was the non-executive chairman. Food safety officers came to visit and found items of foods that were past their expiry date, which is a criminal offence. The defence was based on trying to prove that the two criterion were not satisfied. The court said that it was not enough for a director to simply tell the general manager that '[all applicable legislation is not adhered to.]'

What should directors due to limit their chances of liability? Risk assessment should always be taken as follows, (1) The likelihood of such breaches arising, (2) The extent to which observance is within the control of the director, (3) Severity of the sanction. There are 5 categories of personal liability: Breach of general duties under the Companies Act, Liability for administrative fines under the Companies Act, Liability for administrative fines under ad hoc legislation for ex. PMLA, Liability in insolvency scenario, Criminal liability, direct or vicarious liability.

Duties of an Administrative Nature

Prof Muscat classifies these duties under 6 principal categories, being;

1. Duties relating to the 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

Directors of certain regulated institutions hold responsibilities beyond those outlined in the Companies Act. This applies particularly to 4 categories regulated by the Malta Financial Services Authority (**MFSA**):

(1) directors of credit and financial institutions;

(2) directors of insurance companies;

(3) directors governed by investment services law; and

(4) directors of companies with publicly listed shares or bonds.

These directors have additional obligations under Capital Market Rules when compared to typical directors.

These duties primarily emanate from the Companies Act, but not exclusively (i.e - occupational health and safety act, VAT act, import duties act, PMLFTR, etc). When we come across the Companies Act, we will note several provisions which require affairs such as the handling of a register or the filing of documents within the MBR, for instance. Such duties are often imposed on the Company Secretary in a **joint and several manner with the Directors**. There is a **duty to keep a register of members**, for instance. More importantly, there are several disclosures and filings which need to be made, such as documents such as the **Form K** (signifying a change in directors, change in the company secretary, change in the legal representation ,etc), which results in serious penalties when filed late. There is also the filing of **Form H** (the return of allotments), which must be filed in a specific period of time. If these forms are filed late, the Directors and the Company Secretary may be subject to a fine. Other administrative duties relate to the filing of **Financial Statements**. Directors are not only obliged to draw up financial statements and to have such statements audited, but they also have the obligation to **file the audited accounts with the MBR,** again against a payment for non-

filing or for delayed filing. Another example of such administrative duties is the duty to **file an Annual Return**, which contains within it a description of the Shareholding Structure of the Company, together with the list and details of the Directors of the Company.

In the Companies Act one finds **article 315** (fraudulent trading) and **article 316** (wrongful trading)

Dr Andrew Borg Cardona vs Zammit
Court of Appeal, 14 May 2010

According to these articles, **fraudulent trading** exists where, during the winding-up of a company, it appears that any business of the company has been carried on with intent to defraud the company's creditors or the creditors of any other person, or for any fraudulent purpose. **Wrongful trading**, on the other hand, exists where a company has been dissolved while insolvent and it appears that a person who was a director of the company knew, or ought to have known before the dissolution of the company, that there was no reasonable prospect that the company could avoid dissolution due to its insolvency. These articles of Maltese law were taken from English law. Consequently, English case law and authors constitute an important source for the interpretation of these two articles.

With regard to **fraudulent trading**, prior to the case of *Grantham*, judgments stated that "a proper inference of intent to defraud could be made if a company continues to carry on business and to incur debts at a time when there is, to the knowledge of the directors, no reasonable prospect of the creditors ever receiving payment." In a subsequent case, it was decided that intent to defraud and fraudulent purpose include "actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame."

Following these cases, in *R v Grantham* (1984) the following principles were established:

"A finding that a person was knowingly party to the business of a company having been carried on with intent to defraud creditors may be made if the following two conditions are satisfied:

(1) If that person realised at the time the debts were incurred that there was no good reason for thinking that funds would be available to pay the debt in question when it became due or shortly thereafter; and
(2) There was actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame."

In that case, the English Court made it easier to prove fraudulent intent by holding that "a proper inference of fraud could be made if there was no good reason to believe that payment would be made as aforesaid," and that "dishonesty could be inferred from a reckless disregard of the interests of creditors." In this regard, one must bear in mind, as stated by the author Hannigan B, that "proving that the company continued to trade while insolvent is not enough. The person bringing the action must prove that the respondent has carried on business with intent to defraud creditors or for any fraudulent purpose," and furthermore, "for a person to be held knowingly party to carrying on a company's business with intent to defraud creditors requires findings and inferences as to the facts known to that person at the relevant times. At those times the business might either have succeeded or failed."

Therefore, in similar circumstances, the examination that the Court must undertake is essentially **subjective**, but at the same time must take into account **objective considerations**, since no person will admit to having a fraudulent intention; on the contrary, they will do everything possible to conceal it.

It is only through an accurate examination of these two elements, in the light of the law, that the Court can arrive at a correct assessment and conclusion. Our law, in **Article 315**, states that fraudulent trading exists if, during the winding-up of a company, it appears that any business of the company has been carried on with intent to defraud the company's creditors or the creditors of any other person, or for any fraudulent purpose, but it does not provide a definition of what the word "fraud" means. In the judgment *G. Dalli v M. Attard*, decided on 26 June 1961 by this Court, reference was made to Laurent, who stated that "fraud, like Proteus, assumes a thousand and one forms. It is a question of fact." Consequently, the Court must decide from case to case whether particular conduct, whether active or passive, on the part of directors, in the circumstances of the case, was fraudulent. The Court must examine not only whether there was a fraudulent intention, but also whether **actually dishonest measures** were taken in order to reach the conclusion that fraudulent trading was being carried on.

A director of a company may also be liable in **tort**, if the company's actions were not envisaged in the objects for which the company was established. This was established in ***David Jones vs Dr Joseph Mifsud Bonnici*** *(3rd October 1993)*.

Other duties pertain to **fiscal legislation.** If one is a director of a company, he is automatically considered a representative of the Company. To this we refer to **articles 66** and **82** of the VAT Act;

66 (1) Any secretary, manager, director, liquidator or other principal officer of an entity or of a body of persons, any heir and any testamentary executor and any curator of the vacant inheritance of a deceased person, and any person who is a tutor, curator, administrator or trustee of any other person or of any trust, fund or other entity shall, for the purposes of this Act, be a representative of that body of persons, deceased person, other person, trust, fund or other entity, as the case may be.

82. (1) In addition and without prejudice to any liability of an employee or other person, **where any thing is done or omitted to be done by a body of persons, the provisions of this Part shall apply as if such thing were done or omitted to be done by every director, manager or other principal officer of that body of person**s:

provided that a director, manager or other principal officer of a body of persons shall not be guilty of an offence in virtue of this sub-article if he **proves that he was unaware and could not with reasonable diligence be aware of such act or omission** and that he **did everything within his power to prevent that act or omission.**

If the company does not comply with the VAT Act, the Directors are liable automatically. There is also **article 123** of the Social Security Act and the Merchant Shipping Act, among others, which impose specific duties on directors, which result in their liabilities in case of breach.

Article 7 of the ITMA, if you are a director and the company owes tax and you have sold any asset of the company and you have not used that money for the payment of the income tax then you become personally liable for the payment of the tax of the company.

Powers of Directors

137 (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.

There is a presumption that the directors have a right to **exercise all powers,** unless a reservation has been made in one of 2 places, being either in the **companies act** or in the **memorandum and articles of association**. This is what 137(3) tells us.

In **Luke Sant Berry vs Sant Berry Associations Limited,** a dispute arose when a woman sought to sell a company at a value which her husband alleged to be below market value. The defendant argued that, as a director, she held unrestricted powers unless explicitly limited, thus allowing her to sell at whatever price she chose, since neither the Companies Act nor the M&As prevented her from selling such property at such price.

One should also refer to **article 136;**

136. A company shall, **unless otherwise provided in its memorandum or articles,** have the power to borrow money and to guarantee the obligations of any third party and, for such purpose, to hypothecate or charge its undertakings, property and uncalled capital or any part thereof including as security for its obligations or for those of any third party, and to issue debentures, debenture stock and other securities whether outright or as security for its liabilities or obligations or for those of any third party.

Before 1995, for a company to take a loan or to hypothecate property, the bank had to insist that the company amend the M&As. To amend the M&As, an extraordinary resolution must be passed, which is not easy at times. Thus, in 2006, the legislator introduced a shortcut, through article 136, allowing a company to perform such actions.

Directors have very wide powers. According to **Farrar,** the fundamental aim of company law is to establish a regulatory framework which 'on one hand contains the abuse of directors by their powers, whilst on the other hand does not constrain the directors that the efficiency gains from having a strong centralized management are dissipated."

Pennington`s Company Law (pg. 778):

"Directors' powers are given to them to be used for the benefit of the company, that is for the benefit of the shareholders of the company as a whole ***and not for the benefit of the directors thems****elves,* ***nor for the benefit exclusively of a section of the shareholders or employees of the company*** *... or of outsiders."*

An Objective and Subjective Standard

Each director must exercise a due degree of care, diligence, and skill, which would be exercised by

the reasonable man. To this end, a twofold test is adopted;

The Objective Test: analysing the knowledge, skill, and experience which a person on the board of directors would be expected to possess.

The Subjective Test: analysing the expectation of that director based on his personal knowledge, skill, and experience.

The Law establishes that the director is expected to abide by the due diligence of a bonus paterfamilias. The question arises then as to what happens when the director's personal knowledge and experience surpasses that expected from the bonus paterfamilias.

Traditionally, as seen in ***Re City Equitable Fire Insurance Co***, the subjective test seems to have prevailed.

In ***Alexandra Balzan Ruggier vs Amadeo Balzan*** *(FHCC, 15th September 2015),* the Court referred to ***Brazilian Rubber Plantations and Estate Ltd***, in that;

*"**A director's duty has been laid down as requiring him to act as reasonably to be expected from him, having regard to his knowledge and experience**. He is, I think, not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance. **Such reasonable care must, I think, be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf.** He is clearly I think, not responsible for damages occasioned by errors of judgement."*

Towards the end of the 20th Century, the UK noticed that the subjective test appeared to be too low of a standard. Thus, the objective test was adopted, as seen in ***Dorchester Finance co vs Stebbing***.

Locally, we may refer to ***Charles Sant Fournier vs Philip Attard Montalto*** *(FHCC, 7th November 2001),* in which the Court held;

*Illi f'dan il-kuntest dan il-prinċipju u standard iżiedu t-test oġġettiv mat-test suġġettiv stabbilit minn Neville J, b'mod li **ma huwiex biżżejjed li wiehed jara l-kapaċita' tal-persuna li attwalment tokkupa l-istess pożizzjoni tad-direttur ut sic, iżda dan irid jiġi eżaminat fil- kuntest tal-kariga li huwa jokkupa..."***

Juridical Nature of Directors

Under U.K. Law, the directors have fiduciary duties towards the Company. The notion of fiduciary duties **was** a notion alien to our system - we did not recognise them. Thus, the Maltese Court used to struggle to define the juridical nature of a director. There will thus be judgements which held that the director was to be considered a **mandatary of the company**, such as ***Dr Ian Refalo vs Boweck, (****18th March 1993)*. In 2004, we introduced the notion of fiduciary duties. If we have a look of **article 1124A of the Civil Code**, we will find;

1124A. (1) Fiduciary obligations arise in virtue of law, contract, quasi-contract, unilateral declarations including wills, trusts, assumption of office or behaviour whenever a person (the "fiduciary") -
(*a*) **owes a duty to protect the interests of another person** and it shall be presumed that such an obligation where a fiduciary acts in or occupies a position of trust is in favour of another person; or
(*b*) **has registered in his name, holds, exercises control or powers of disposition over property for the benefit of other persons**, including when he is vested with ownership of such property for such purpose; or
(*c*) **receives information from another person subject to a duty of confidentiality** and such person is aware or ought, in the circumstances, reasonably to have been aware, that the use of such information is intended to be restricted.

Per **article 1124A** of the Civil Code, the director also falls under the classification of fiduciaries of companies. It is safer, however, to say that the director is a ***sui generis animal*** which **goes beyond being a fiduciary of the company**, having also specific duties under the Companies Act as well as under a number of other legislation. Traditionally the *director* is seen to be a mandatary in the eyes of Profs. Cremona's notes where they are regarded as *mandataries* and *agents.*

As stated in the case of ***Michael J.Falla vs John H.Sorotos*****, 1976,** a shareholder does not have a locus standi in an action against the director for breach of the latter of his duties because the director owns his duties to the company as they are **mandataries** of the company and in the breach of their duties, they are liable to the company, therefore, the action is exercisable by the company itself.

Profs. Muscat states, "The correct legal position, it is submitted, in is to regard the director as a type of mandatary whose legal position in such capacity is regulated primarily by the Companies Act." **A director, under UK law** is considered to be a **fiduciary.** Our courts were trying to pigeonhole this nature however it was not successful, until 2004, where **Article 1124A** was introduced on fiduciary obligations. Since

fiduciary obligations were introduced, they are now considered to be fiduciaries. The director who exercised control over the property of a company and has the power to dispose of it, it is thus a fiduciary. The notion of a fiduciary obligation is also embedded in the **Companies Act under Article 136A (1) which reads,** *"A director of a company shall be* ***bound*** *to act* ***honestly*** *and in* ***good faith*** *in the* ***best interests*** *of the* ***company."***

136A. (1) A director of a company shall be bound to act honestly and in good faith in the best interests of the company.

(2) The directors of a company shall promote the well-being of the company and shall be responsible for:

(*a*) the general governance of the company and its proper administration and management; and

(*b*) the general supervision of its affairs.

(3) In particular, but without prejudice to any other duty assigned to the directors of a company, or to any one of them, by the memorandum or articles of association or by this Act or any other law, the directors of a company shall:

(*a*) be obliged to exercise the degree of care, diligence and skill which would be exercised by a reasonably diligent person having both -

(i) the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and

(ii) the knowledge, skill and experience that the director has;

(*b*) not make secret or personal profits from their position without the consent of the company, nor make personal gain from confidential company information;

(*c*) ensure that their personal interests do not conflict with the interests of the company;

(*d*) not use any property, information or opportunity of the company for their own or anyone else's benefit, nor obtain benefit in any other way in connection with the exercise of their powers, except with the consent of the company in general meeting or except as permitted by the company's memorandum or articles of association;

(*e*) exercise the powers they have for the purposes for which the powers were conferred and shall not misuse such powers.

This is the basic fiduciary duties expressed in the Companies Act. When speaking of **the best interest of the company**, the legislator's intention is clear. When speaking of **honesty and good faith**, English

authors tell us that one should test on **common sense principles** - the Court should ask whether it is proven that the directors have not done what they honestly believed to be right, normally accepting that they have, unless satisfied that they have not behaved as honest men of business might be expected to act. The directors have to use their powers for **the purposes for which such powers were given**, and not for an **improper purpose**. They must also act ***intra vires***. They cannot perform ***ultra vires*** or **illegal activities**.

There is a bit of overlap between the fiduciary duties under the Companies Act and the fiduciary duties under the Civil Code;

Anthony Caruana Limited vs Chris Caruana

Court of Appeal 28th February 2014

This Court will now consider the plaintiff company's incidental appeal relating to the fact that the First Court did not agree that the defendant acted in breach of his fiduciary obligations. This Court observes that although it is true that Article 1124A of the Civil Code came into force after the facts giving rise to this case had occurred, that article is nothing more than a reproduction of a principle of law already applicable in Roman law, where it was considered a "parasitic institution" (see Lee, *The Elements of Roman Law*, p. 340), not as a contract, but as something which imposes **additional obligations beyond the contractual ones** in the case of certain contracts.

The concept of fiduciary obligations is not necessarily tied to the concept of **trusts**, which were fully incorporated into the Maltese system on 1 January 2005, and is of general application in any case where a person is acting in the interest of someone else and is therefore expected to act with due care and diligence. As the Court of Magistrates (Gozo), Superior Jurisdiction, stated in ***Cordina v. Cordina*****,** decided on 26 September 2007, with the introduction of Article 1124A in the Civil Code, the situation "**became much clearer**", but **no new concept was created**.

As the First Hall of the Civil Court stated in ***Messina v. Galea***, decided on 5 January 1881, Roman law was and remains the *ius commune* of Malta, and "in cases not provided for by our laws, we must resort to Roman law." The concept of trust between the principal and his representative has long existed in our legal history, and when one considers that the defendant occupied the post of General Manager, it is clear that **equity imposed upon him duties and obligations that go beyond his contractual obligations**. A manager is said to owe duties of prudence and loyalty toward his principal. As the late Professor Joseph A. Micallef stated in his notes on the Commercial Code (pp. 121–123):

"The office of manager from the legal point of view embraces both the concept of agency and the contract of Kopja Informali ta' Sentenza trust which arises between the manager and his principal and he must, personally perform the duties which go with this office…. The manager is an agent of the principal. He acts on his behalf and in his name. But he also administers the affairs of the principal and is in charge of the business or a branch of business of the principal in one or more fixed places. He is therefore the mandatory of the principal and the main function of his office is to increase the prosperity of the principal. He is therefore also the lessor of work and industry. These characteristics have been referred to by the Commercial Court, Judge Profs. Parnis presiding, in the case ***Zammit vs Galea et*** decided on the 5th March 1907. The **manager is therefore in relation to his principal an administrator, namely a mandatory and a lessor of work while in relation to third parties he is the representative that binds the principal and therefore is his agent**." Il-manager allura avolja m'ghandux responsabbilta` ta' *policy making*, huwa fiducjarju tal-principal tieghu u jrid jagixxi dejjem in bona fede u b'lealta`.

The case that has really gone into the fiduciary duties of directors is the case of ***GBCom Ltd vs Vella Falzon pro et noe*** *(30th November 2020)*. In this case, GBCom Limited was a shareholder in a company with a structure of companies headquartered in Switzerland and with a number of subsidiary companies in Malta. The purpose of the group was to trade in grains, which is a multimillion dollar business. GBCom Ltd had a minority shareholding in this company. There were another 2 foreign shareholders. They were trading, and at one point, sales started going down. The beneficial owners of GBCom Ltd and these other 2 foreign shareholders were all directors of the main company. GBCom Ltd sold its shareholding to the other 2 shareholders, after which it discovered that the other 2 shareholders, behind their back, had been performing the same transactions that the main group was performing, keeping profits from the third shareholder. Thus, a suit was filed, holding the other 2 shareholders personally liable for these losses**. The whole case hinged on whether there was a breach of fiduciary duties or not**. **Mr Justice Mckeon** gave a detailed discussion on what constitutes fiduciary duties. The judge ruled against the plaintiff, holding that it was not convinced that the defendant was not aware of the transactions being carried out.

GBCom Ltd vs Vella Falzon pro et noe

30th November 2020

Fil-pagni 567 et seq ta` Principles of Maltese Company Law (Second Edition – Volume Two – 2019 - MUP) **Andrew Muscat** ighid :-

"Directors can also be regarded as fiduciaries. The notion of fiduciaries was introduced into Maltese civil law by amendments to the Civil Code in 2004. A fiduciary is defined as a person who (a) owes a duty to protect the interests of another person, or (b) holds, exercises control or powers of disposition over property for the benefit of other persons, including when he is vested with ownership of such property for such purpose; or (c) receives information from another person subject to a duty of confidentiality and such

person is aware or ought, in the circumstances, reasonably to have been aware, that the use of such information is intended to be restricted. **As has also been discussed, a director falls at least under the first limb of the said definition and may also qualify as a fiduciary under the second and third limbs.**

…

A fiduciary has a fundamental duty to carry out his obligations with utmost good faith and to act honestly in all cases. This duty of good faith and honesty cannot be excluded by contrary agreement. Apart from this general duty, fiduciaries are also subject to a number of specific duties which can be modified or excluded either by express provision of the law or by the express terms of an instrument in writing.

These specific duties can be divided into three categories: duties of loyalty, duties of care and administrative duties.

The duties of loyalty comprise (a) the duty to avoid any conflict of interest (b) the duty not to receive undisclosed or unauthorised profit from his position or functions; (c) the duty to act impartially when the fiduciary duties are owed to more than one person; and (d) the duty to return on demand any property held under fiduciary obligations to the person lawfully entitled thereto or as instructed by him or as otherwise required by applicable law.

The fiduciary's duty of care is expressed as the duty "to exercise the diligence of a bonus paterfamilias in the performance of his obligations."

On the administrative side, the fiduciary is obliged (a) to keep any property as may be acquired or held as a fiduciary segregated from his personal property and that of other persons towards whom he may have similar obligations; (b) to maintain suitable records in writing of the interest of the person to whom such fiduciary obligations are owed and (c) to render account in relation to the property subject to such fiduciary obligations.

A fiduciary who acts in breach of his fiduciary obligations, **is in addition to any other remedy that may be available at law, bound to return any property together with all other benefits derived by him, whether directly or indirectly, to the person to whom the duty is owed**. The obligation to return property derived from a breach of a fiduciary duty shall apply also to all property into which the original property has been converted or for which it has been substituted."

Issir referenza ghad-dottrina u ghall-gurisprudenza li kienet citata minn din il-qorti kif presjeduta fis-sentenza li taghha tad-29 ta` Settembru 2016 fil-kawza "***Desmond Mizzi et vs KPMG et***" (mhux

appellata) : Fis-sentenza ta` din il-qorti kif presjeduta tat-2 ta` Dicembru 2013 fil-kawza "***Carmen Xuereb v. L-Avukat Anton Micallef***" inghad :-:

" … Fiducjarju ghandu l-obbligu li jzomm u jittratta taghrif li jircievi b`mod kunfidenzjali. Ghandu

d-dmir ta` lealta` fl-amministrazzjoni. Ghandu d-dover li jhares l-interessi tal-persuna li tkun tatu l inkariku. Ghandu jiehu hsieb b`onesta` u b`kontabilital-affarijiet ta` min ikun tah l- inkariku. Ghandu jezercita d-diligenza ta` bonus pater familias fit-twettieq tal-obbligazzjonijiet tieghu. M`ghandux ikollu konflitti ta` interess, ghandu dejjem jagixxi fl-interess ta` min tah l-inkariku u m`ghandux jircievi profitt mhux awtorizzat."

Persuna tista` titqies li hija "*direttur*" ghall-finijiet u effetti kollha tal-ligi, jekk tkun *tmexxi* kumpannija, anke jekk tkun tissejjah *manager*. Ghalhekk fis-sustanza, li jghodd mhuwiex it- titolu jew l-isem tal-kariga li jkollha persuna, izda l-funzjoni dirigenzjali fis-sens tat-tmexxija li l-persuna jkollha fil-kumpannija. Fil-kuntest Malti, direttur jassumi l-funzjoni *de jure* meta jkun formalment u validament mahtur skont il-ligi u registrat mar-Registratur tal- Kumpanniji. Fl-Ingilterra kienet trattata fid-dottruna u fil-gurisprudenza l-figura ta` diretturi : *de facto* u *shadow directors* (dawn tal-ahhar b`referenza specifika ghalihom f`Sec 250 tal-Companies Act 2006).

Vascas Enterprises Limited C17826 vs Ellul Adrian,

FHCC, 13/11/2014

Making preparatory acts before resigning was not a breach of fiduciary obligations. The plaintiff claimed that the director defendant made preparations to leave his job, by reducing order with one supplier, while establishing personal contact with them so that, on quitting his job, he would make orders in his own name directly from this supplier. In a UK case, **Ranson v Customer Systems plc[27/06/2012]** the court held that *" a 'fiduciary' duty should not be confused with a duty of 'fidelity'.* The latter does not amount to a *'promise to give his employer the benefit of every opportunity within the scope of its business'.* It was not shown that Ellul failed in his duties. Ellul wished to leave his job with Vascas and requested assistance from one of Vascas' suppliers. There was no breach of loyalty towards Vascas, pointed out the court.

The Law of Meetings

Companies have 2 fora, one for the shareholders and one for the directors. The meetings for the shareholders are referred to as General Meetings, while the meetings for Directors are referred to as Board Meetings.

General Meetings

General Meetings take one of two basic forms, being the **Annual General Meeting (AGM)** and the **Extraordinary General Meeting**.

One must make a distinction between an AGM and a Class Meeting. The General Meeting is the annual meeting of all the shareholders of the company. On the other hand, if the share capital of the company is divided into different classes of shares, then each class of shareholders may have a meeting of that class of shareholders, being a class meeting, in which the particular class may agree on a position to take during the AGM. The annual general meeting must occur once per year. No more than 15 months shall elapse between one AGM and another. **The only exception to this rule is when the company is newly registered, in which case the first AGM may be held after 18 months**, with no subsequent meeting having to be held in the year of its registration, nor in the subsequent year.

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.

Typically, the first item on the agenda of the AGM would be the approval of the agenda of the minutes of the prior general meeting, which is a bit ridiculous, since let us imagine that there would be a meeting on the 1st December 2023. The minutes of the AGM will be approved on the 1st December 2024. The next item on the agenda of the AGM is the approval of the financial statements for the previous year. Then, there will be the appointment of the directors of the following year, as well as the appointment of the auditors for the coming year. Lastly, if directors would have recommended a dividend, then at the AGM, the shareholders will resolve to pay out that dividend.

Thus, at the AGM, the shareholders are to decide who shall be vested the management of the company for the coming year. They will delegate their powers to directors so that they can administer the company for the coming year. The appointment of the **auditor** is a crucial element in the control of the company. It is the shareholders who appoint the auditor, because at the end of the day, the auditor is going to check the work of the directors, and so it suits the shareholders to ensure that the auditor is of proper standard in order to supervise the work of the directors. As previously stated, the payment of the dividend is usually the last line of business in every AGM. The shareholders have no right to declare a dividend - unless the dividend is proposed by the directors.

If the directors do not recommend the payment of the dividend, then the shareholders cannot decide to grant a dividend - this decision is taken by directors.

Let us imagine a scenario where some directors are shareholders and some directors are not. If the directors do not recommend a dividend year after year, and the directors keep reaping up profits by increasing their salary, then we have a situation whereby some shareholders are being paid and some are not. There may be grounds for an unfair prejudice action, which is still being decided by the Courts.

Vis-a-vis the approval of financial statements, there will be an audit report and a directors' report, which are presented alongside the financial statements, as components thereof. The financial statements take the form of the P&L and the balance sheet. The former contains all the revenues and expenses, while the latter shows the company's assets (including depreciation), liabilities, and capital, as at a certain date. These must contain a true and fair view of the state of the company.

The auditor is to guarantee that the financial statements present a true and fair view of the financial state of the company. The financial statements will also contain the audit report and the directors' report. The latter refers to the document which ensures that the directors assume responsibility for the financial statements. More importantly than this document is the auditor's report. The auditor's report serves to check whether the report is **qualified or not**. A qualified auditor's report is one which protects the auditor, who holds in such report that he was not in a position to verify certain features or values. A qualified auditor's report thus raises certain red flags. The auditor may qualify the entire report, or else only certain parts of the financial statements. The auditor is to assume personal liability for the contents of the report.

Valle del Miele v. Raphael Aloisio et

The judgement emphasises several key points regarding **auditors' reports**, their **duties**, and **potential liabilities**. The auditors were **accused of negligently preparing accounts** and their statutory report, presenting an overly optimistic view of the company's financial health, which misled the plaintiff company into extending more credit than would be prudent.

The judgement discusses the principle that auditors **may owe a duty of care not only to their clients but also to third parties who rely on their reports**. The English judgement in ***Candler v. Crane, Christmas & Co***. by Lord Denning is extensively cited, emphasising that professionals like auditors can owe duties to those they know will rely on their work.

The concept of "**sufficient proximity**" between the negligent act (auditor's misrepresentation) and the damages suffered is critical. This principle aligns with decisions in ***Hedley Byrne & Co. Ltd. v. Heller and Partners Ltd***. **Auditors have an obligation to ensure the accuracy and fairness of their reports**, not just **for the satisfaction of their direct client** but also **for external stakeholders** like shareholders and creditors, who rely on these reports for significant financial decisions. The judgment reflects the idea that auditors should foresee the impact of their reports on third parties and act responsibly, failing which they could be held liable for negligence.

Candler v. Crane, Christmas & Co.

Lord Denning's dissenting opinion is foundational, stating that accountants owe a duty of care to third parties they know will rely on their work:

"They owe the duty… to their employer or client; and also, I think, to any third person to whom they know their employer is going to show the accounts so as to induce them to take some action on them."

Hedley Byrne & Co. Ltd. v. Heller and Partners Ltd.

The **principle of liability for negligent misstatements** is highlighted, establishing the duty of care owed by professionals when their work is intended to be relied upon by others. In tandem, ***Home Office v. Dorset Yacht Co.***, ***White v. Jones***, and ***Henderson v. Merrett Syndicates Ltd.*** all continue to reinforce the evolving principles of **professional liability and negligence**.

Extraordinary General Meetings

The AGM is the shareholders' opportunity to verify the affairs of the company. This is the purpose of the AGM. Meetings are regulated by **articles 128** et seq of the Companies Act. These provisions hold that any meeting which is not the AGM is deemed to be an **extraordinary general meeting**. An extraordinary general meeting is one where directors meet up to decide on specific affairs of the company, such as whether the shareholders want to merge, want to file a procedure for corporate recovery, whether they want to dissolve, to make amendments to the M&As, etc. **Whenever an extraordinary affair arises, an extraordinary general meeting is called for.**

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.

While EGMs are typically convened by directors, Article 129 of the Companies Act tells us that **if at**

least 10% of the shareholders of a company file a request for the convening of an extraordinary general meeting, then within 21 days from the filing of this request, the directors must convene an extraordinary general meeting. In this requisition, the object of the meeting must be stated, it must be duly signed by the shareholders making such request, and the requisition must be delivered at the registered office of the company. Furthermore, if the directors do not convene the meeting, then the law grants the right to the applicant shareholders themselves to convene the meeting. **This is thus a residual right given to the shareholders to convene an extraordinary general meeting, where the directors fail to host such a meeting after the application is filed.** The requisitionists are also entitled to be refunded all the expenses incurred to convene such a meeting.

129. (1) The directors of a company shall on the requisition of one or more members of the company, holding not less than one- tenth of the paid-up share capital of the company on the date of the deposit of

the requisition, which share capital carries the right of voting at general meetings of the company, forthwith proceed to duly convene an extraordinary general meeting of the company within twenty-one (21) days from the date of the deposit of the requisition, to be held not later than two (2) months from the date of the deposit of the requisition.

(2) The requisition shall state the objects of the meeting and shall be signed by the requisitionists and deposited at the registered office of the company and may consist of several documents in like form, each signed by all the requisitionists.

(3) If the directors do not duly proceed to hold a meeting as referred to in sub-article (1), the requisitionists may convene a meeting in the same manner, as far as possible, as that in which meetings are to be convened by the directors, provided that such a meeting shall be held before the expiration of three (3) months from the date of the deposit of the requisition.

(4) Any reasonable expense incurred by the requisitionists by reason of the failure of the directors to hold a meeting shall be repaid to the requisitionists by the company, and any sum so repaid shall be due personally by the directors who were in default and may be retained by the company out of any amount due or which may become due by the company by way of fees or other remuneration in respect of their services to such directors who were in default.

The affairs which may decided upon by reason of an extraordinary general meeting are contained within the Companies Act - thus the Act will tell you when you require an EGM. Article 129 has a huge practical use as it gives a certain degree of power to minority shareholders as it gives them power to bring a matter forward to the table that is bugging them.

Previously, cases arose as to whether the decision must be taken within the 21 days established by article 129 or not. The law used to state that within 21 days you must convene the meeting (meaning that the meeting may be set for any day after the 21 days, and thus the meeting may be delayed by years provided that the meeting was set within 21 days from the filing of the requisition). However, in ***Absolute Holding Limited*** *6/10/2023*, the Court noted that the law did not say when the meeting is to be held, thus signifying a lacuna. The law was then amended in 2024 to state that the meeting must be held **within 3 months** from the date of deposit of the requisition.

Absolute Holding Ltd. v. X *(2023)*

The judgment outlines a handful of key points regarding company meetings.

The board of directors is **obligated under §129 (3) to convene a meeting within 21 days from requisition**. However, **NO maximum time frame for holding the meeting was stipulated in the law at the time of the judgement**, allowing the directors to schedule meetings significantly in the future if they

deem it appropriate. In this case, the Extraordinary General Meeting (EGM) was scheduled nearly 11 months after the requisition.

The directors are required to act in compliance with statutory duties, including addressing regulatory requirements. In this instance, it was alleged that the board failed to adequately resolve issues raised by the Malta Financial Services Authority (MFSA) during a prior compliance review.

A major shareholder raised concerns about governance and the delayed scheduling of meetings, asserting that these actions impeded their rights and negatively affected the company. The court heard that the shareholder requested the meeting to address governance and compliance issues, particularly regarding the composition of the board.

The board defended its decisions, arguing that no urgency existed for an earlier meeting and that the scheduled date was in line with their duties and the law. It also highlighted the absence of governance problems and compliance with MFSA requirements.

Other instances in the CA wherein EGMs may be convened

329A. Where the directors of a company become aware that the company is **unable to pay its debts or is imminently likely to become unable to pay its debts**, they shall forthwith, not later than thirty days from when the fact became known to them, 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 reviewing the company's position and of determining what steps should be taken to deal with the situation, including consideration as to whether the company should be dissolved or, where applicable, whether the company should make a company recovery application in terms of article 329B.

329A is an **obligation of directors**. It imposes specific duties on directors **when they become aware that the company is unable to pay its debts or is imminently likely to become unable to do so**. Upon gaining such awareness, the directors are obligated to act promptly. They **must convene a general meeting of the company within 30 days of becoming aware of the financial distress**. This meeting must be called by issuing a notice specifying the purpose and scheduling the meeting for a date not later than forty days from the issuance of the notice.

The primary purpose of this meeting is to review the company's financial position and determine the appropriate steps to address the situation.

The provision ensures that directors act transparently and involve shareholders and possibly creditors in critical decisions about the company's future. It also **holds directors accountable, preventing them from ignoring or delaying action in the face of financial difficulties**. Timely compliance with this obligation can protect the company's value, preserve stakeholder interests, and mitigate potential losses. **Failure to act as required may expose directors to legal consequences, including personal liability for the company's debts or accusations of wrongful trading, depending on the jurisdiction**. This emphasises the importance of proactive and responsible management in times of financial distress.

Further, Article 160 discusses the possibility of an EGM upon the request of the auditor of the company.

160. (1) The provisions of this article shall apply where an **auditor's notice of resignation is accompanied by a statement of circumstances which he considers should be brought to the attention of members or creditors of the company.**

(2) The resigning auditor may deposit with the notice a signed requisition calling on the directors of the company forthwith duly to convene an extraordinary general meeting of the company for the purpose of receiving and considering such explanation of the circumstances connected with his resignation as he may wish to place before the meeting.

An extraordinary general meeting is also catered for in article 132, which gives the power to the Court to convene a meeting when it is not practical to call or conduct a meeting. Discretion is in the hands of the directors to establish the date for the holding of the general meeting. If they do not convene a general meeting as they are duty bound to do, then there is a fallback position found in article 132 of the companies act

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.

When an extraordinary meeting is called, all those entitled to be present for the meeting must be given a notice of the meeting. We say *entitled to be present* because shares may be subject to usufruct. This is done in order to qualify for certain tax exemptions. This is achieved when the bare owner passes the share to

their children, having a usufruct established in their favour. Thus, the notice is given to **both the usufructuary** as well as the **bare owner** of those shares.

The articles of association will also tell you how the notice is to be served as well as the duration of the notice period.

An important case regarding 132 is that of ***Jarrow ltd. Vs Ruth Azzopardi***. Decided by Judge Spiteri Baylee.

There is a very good explanation of the article its source and its workings and a good case about meetings in general.

The directors decide to convene except when there is the application of article 132 and they must give a notice of the general meeting. This notice must be given to all the shareholders. Besides the shareholders notice is also given to the directors and to the auditor of the company who presents the auditors report during that general meeting.

If you do not give notice as you should give, whatever takes place at a general meeting or at an EAGM the proceedings shall not be valid. The first schedule of the companies act that deals with notices there is a waiver of this invalidity.

130. A general meeting of a company shall be deemed not to have been duly convened unless at least fourteen days' notice has been given in writing, and any provision in the company's memorandum or articles shall be construed as requiring fourteen days' notice in writing in so far as it provides for the calling of a meeting of a company, other than an adjourned meeting, by a shorter notice:

Provided that a meeting of the company shall notwithstanding that it is called by a shorter notice, be deemed to have been duly convened if it is so agreed by all the members entitled to attend and vote thereat.

Article 130 tells us that the time period of the notice may be shortened. However, normally, 14 days notice must be given. The first schedule of the Companies Act tells us that in the standard and default articles of association, there is a clause which holds that the accidental omission of giving a notice does not invalidate the proceedings of the meeting. Thus, this article sort of invalidates the whole scope of the requirement of notice. It is thus suggested to amend this clause when preparing the articles of association.

Together with the notice of the general meeting, a proxy form must also be attached.

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.

The proxy is used when there may be some form of resentment between shareholders, among other reasons.

The applicability of 133 is notwithstanding the memorandum and articles is maintained. This article may be used to buy time. A notice was sent of a general meeting to have a director removed and a proxy form was not sent and thus a mandate of inhibition was done so the meeting cannot be held because there is no proxy form.

P.M.S. (Holdings) Ltd vs. X

28/01/2021

There was a company, 'Jaguar Limited' and 90% shareholder belonged to a man and the other 10% to PMS Holdings Limited. The man passed away and he left 90% bare shareholding to his grandchildren from his first wife and he left the usufruct of these shares to his second wife. His second wife did not accept the inheritance but did not refuse it either, but she simply waited for how things would develop. In the meantime, the company was incurring fines with MFSA, and the sole director of the company was the man who passed away. An application to the court was filed and it was filed in a way that was ambivalent. **The court was asked in terms of Article 132 to convene a meeting of the shareholders, an annual general meeting** and at this annual general meeting, the presence of …. Where the number of directors falls below 2, it is possible for any member of the company to ask the court to appoint a directors. It was done this way because of the wording used in Article 132. Here, the court can invoke the right of invoking a meeting in 2 scenarios:

A. It if is impracticable to call a meeting of the company in any manner in which it may be called.

B. If it is impracticable to conduct the meetings of that company in the manner prescribed by the articles or the act.

The court in this case held that Article 132 of Chapter 386 was Article 371(1) of the **UK Companies Act of 1985**, and it has now become Article 306 of the UK Companies Act of 2006. The court also **r**emarked that under English law, the equivalent to Article 132 is only applicable to shareholders meetings and not directors meetings.

The court quoted **Prof Muscat's book** where he held that:

"The court may exercise this power if, for any reason, it is impracticable (i) to call a meeting of a company in any manner in which meetings of the company may be called or (ii) to conduct the meeting in the manner prescribed by the articles or the Companies Act. The court should be entitled to direct that a meeting be held when it is impossible to hold a general meeting because of the persistent absence of a quorum at general meetings. **The court should not however direct that a meeting be convened simply because the directors had rejected a request by a member to call a meeting.** Nor should the court use its powers to **overcome a deadlock in the company`s affairs** where the deadlock is the result of a deliberately created parity of votes between two members. Indeed, **the legislative provision is designed to empower the court to ensure that meetings are held but not to alter the result that is likely to follow from that meeting**. Where however the provisions of the articles are cynically exploited by some shareholders to block an effective meeting, the court should be able to exercise its powers.

The court may exercise its power either (i) on its own motion or on the demand of either of the parties to proceedings before it during the course of such proceedings, or (ii) in the absence of such 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. The court may order that the meeting be called, held and conducted in such manner as it thinks fit, and it may, whenever any such order is made, 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 is to be deemed to constitute a meeting."

"Where a general meeting is convened by the court under the powers conferred on it by the Companies Act the court may notwithstanding any provision in the articles of association direct that one member of the company present either in person or by proxy is to be deemed to constitute a meeting."

In this case, the court held that it should not invoke **Article 132** and instead it gave the remedy in terms of **Article 137(7)**. It appears that **Article 132** is there when there is absolutely no legal way around things or when a shareholder is acting in such a way as to frustrate the holding of the meeting. For example, a shareholder whose presence is necessary to have a quorum in the meeting keeps refusing to attend the general meeting.

Absolute Holdings vs X

Confirmation of the interpretation of this is seen in the Absolute Holdings case. This case was based on **Article 132** because the plaintiffs in this case stated that they tried to convene a meeting in terms of **Article 129** …. The court said that the law has given a remedy, a meeting is going to be convened, there is not breach of the law and hence a remedy cannot be given as the **2 impracticability test**s have not been satisfied.

The Quorum for AGMs and EGMs

Both the AGM and EGM may only take place when a **quorum is attained**. The Articles of Association establish this quorum. If the articles do not contain this quorum, then the fallback position is that of Article 131 of the Companies Act, stating that at least 2 members must be present.

In establishing a quorum, **the proxies are not counted**. The proxies are not taken into consideration when seeing if a quorum is reached or not, as held in article 131(b);

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.

At the meetings, resolutions are proposed. Normally, one share carries one vote. Such votes are taken in relation to proposed resolutions. Sometimes, the Articles may provide that A shares carry 10 votes per share, while B shares carry 2 votes per share (**weighted voting**). When a matter is put to the vote, there are 3 options; you can vote in favour, you can vote against, or you can abstain. Usually, abstaining is a good strategy, sometimes even motivated by politics. A meeting may be adjourned for another date, if not all matters were voted upon. At every meeting, a chairman must be appointed. This is provided for under article 131(c). Articles may deviate from this provision. It must also be

decided whether the chairman should have a casting vote. Everything which is said in the meeting must be minuted by the Secretary.

It is the directors' discretion on the date, time and place of the meeting. A notice of the meeting has to be sent to every member of the company, even members who do not have a vote at the general meeting (when shares are subject to usufruct). The auditor has to receive a notice of the meeting as well as the directors because the directors have to answer the questions/queries raised by the shareholders. The company secretary will also be present.

How is the notice thus served? By default, in terms of **Article 131(a)**, you have to serve the notice in the manner described in the First Schedule of the Companies Act. But every company in its Articles may alter the manner in which notices are going to be effective such as by registered mail. If this is not written down, then you have to rely on the contents of the First Schedule. The standard notice period is 14 clear days. The Articles of Association may cater for a different notice period but if it is contained in the Articles, it is what shareholders bargained for. The content is simple and straightforward, one is informing that a meeting will be held on this specific day. There is an important tool as if a shareholder cannot attend the meeting, or if the matter being discussed requires a certain degree of a legal accountancy or management background, the shareholder can appoint someone else that will attend and vote on his behalf for that meeting.

Ordinary Resolutions

134. (1) Any provision contained in the memorandum or articles of a company shall be void in so far as it would have the effect either-

(*a*) of excluding the right to demand a poll at a general meeting on any question other than the election of the chairman of the meeting or the adjournment of the meeting; or

(*b*) of making ineffective a demand for a poll on any such question which is made either -

(i) by not less than five members having the right to vote at the meeting; or

(ii) by a member or members representing not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or

(iii) by a member or members holding shares in the company conferring a right to vote at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

(2) The instrument appointing a proxy to vote at a meeting of the company shall be deemed to confer authority to demand or join in demanding a poll; and for the purposes of sub-article (1) a demand by a person as proxy for a member shall be the same as a demand by the member.

(3) On a poll taken at a meeting of a company or a meeting of any class of members of that company, a member entitled to more than one vote need not, if he votes, use all his votes or cast all the votes he uses in the same way.

135. (2) An ordinary resolution shall be passed by a member or members having the right to attend and vote holding in the aggregate shares entitling the holder or holders thereof to more than fifty per cent of the voting rights attached to shares represented and entitled to vote at the meeting, or such other higher percentage as the memorandum or articles may prescribe.

Extraordinary Resolutions

Resolutions taken at a GM are ordinary resolutions. At an EAGM they are extra ordinary. The distinction is contained in 135.

135. (1) A resolution shall be an extraordinary resolution where-

(*a*) it has been taken at a general meeting of which notice specifying the intention to propose the text of the resolution as an extraordinary resolution and the principal purpose thereof has been duly given; and

(*b*) it has been passed by a member or members having the right to attend and vote at the meeting holding in the aggregate not less than seventy-five per cent in nominal value of the shares represented and entitled to vote at the meeting and at least fifty-one per cent, or such other higher percentage as the memorandum or articles may prescribe, in nominal value of all the shares entitled to vote at the meeting:

Provided that, if one of the aforesaid majorities is obtained, but not both, another meeting shall be convened within thirty days in accordance with the provisions for the calling of meetings to take a fresh vote on the proposed resolution. At the second meeting the resolution may be passed by a member or members having the right to attend and vote at the meeting holding in the aggregate not less than seventy-five per cent in nominal value of the shares represented and entitled to vote at the

meeting. However, if more than half in nominal value of all the shares having the right to vote at the meeting is represented at that meeting, a simple majority in nominal value of such shares so represented shall suffice.

…..

(3) In the case of a private company a resolution shall be an extraordinary resolution where -

(*a*) the provisions of sub-article (1)(*a*) are complied with; and

(*b*) it has been passed by a number of members having the right to attend and vote at any such meeting holding in the aggregate not less than fifty-one per cent in nominal value of the shares

conferring that right or such other higher percentage as the memorandum or articles may prescribe.

When you have an ER in the notice you must propose the text of the resolution and give the purpose for that resolution. There are 2 different thresholds depending on whether the company is public or private. In the case of a private company, it is contained in the M and A and very much depends on the dynamics of the shareholding of that company.

You may have a resolution in writing, in that it is not voted upon in a meeting, but it is passed by a

vote of the shareholders without having to call for a meeting, per article 210;

210. Subject to the provisions of this Act, **in the case of a private company**, a resolution in writing signed by all the members for the time being entitled to receive notice of and to attend and vote at the general meetings shall be as valid and effective as if the same had been passed at a general meeting of the company duly convened and held and the provisions of article 155 shall not apply. Annual general meetings of the company may be held in accordance with this article:

Provided that a resolution in writing as aforesaid shall be void if it purports to remove a director or an auditor before the expiration of his term of office, or otherwise purports to deprive the auditors of the right to attend and be heard at any general meeting of the company on any part of the business of the meeting which concerns them as auditors.

For public companies, this must be contained in the articles for it to be effective.

Board Meetings

Board meetings are the meetings held by the directors. There is no distinction between ordinary and extraordinary resolutions for the purposes of board meetings. They simply meet to decide on affairs.

Most companies function without the convening of proper board meetings. Only when problems start to creep in then it becomes imperative that a board meeting takes place. There is the requirement of a quorum, like in AGMs and EGMs. The rules relating to chairman, minuting, adjourning, etc, are equally applicable to Board of Director Meetings.

They follow the pattern of general meetings very much, but they are more relaxed and less formal. The directors can convene the meetings at liberty to discuss things. In more serious companies, board of directors are held. In other companies, no meetings are held. One has to see if the articles cater for a notice period, or whether meetings can be held at shorter periods of time. Resolutions at BOD meetings are not ordinary or extraordinary but simply resolve what they are going to do stepping forward. There is the requirement of a quorum of how many directors need to be present and the rules regarding the holding of meetings such as minutes, appointment of chairman, are equally applicable to BOD meetings.

Very often it is the chairman who decides to convene but any director can ask for a meeting to be convened. The notice period for the convening of the directors meeting is normally 14 days but the M and A can have a shorter notice period and if all the directors agree you can waive the requirement of a notice. In terms of article 132(2) the court also has a residual power to order the convening of the director’s meeting.

The Formation of a Company

A company is formed by the registration of certain documents with the registrar of Companies. Before delving into the formalities of registration, one ought to keep in mind that the Companies Act distinguishes between two types of LLCs, being the private company and the public company. As will be seen below, the formalities for the registration of the two types of companies are not identical. Moreover, the Companies Act provides that a company, whether private or public, may be formed as an **investment company with variable share capital**. The Companies Act also provides that a public company which complies with certain requirements will be deemed an **investment company with fixed share capital.** The formalities required for the registration of these types of investment companies also vary from the formalities required for the registration of public and private companies.

With regards to the required formalities, one should take into account 1) The residence of the subscribers of the association (i.e - whether the subscribers fall part of the EEA), 2) The Juridical Nature of the subscribers (i.e - whether they are physical or legal persons), and 3) whether the subscribers are to sign the memorandum and articles of association themselves or whether they are appointing mandataries to sign in their name.

Article 68 of the Companies Act lays out the general rule applicable to all companies vis-a-vis registration, in that all companies must enter into a **memorandum of association** subscribed to by at least 2 persons (or by the single member in the case of the single member company per **article 212**). Further, all companies must obtain a certificate of registration from the MBR.

68. A company shall not be validly constituted under this Act **unless a memorandum of association is entered into and subscribed by at least two person**s, or in the case of a single member company constituted in terms of article 212, by the single member, and a certificate of registration is issued in respect thereof. Companies formed and registered under the Ordinance shall comply with this Act in accordance with the provisions of article 428.

This article makes use of the word **subscribe** in relation to the original members of the company - this term is unusual in the context of Maltese Law, since this is the only instance where the term

subscribe is being used instead of the word *sign*. Nonetheless, in this context, the provision states that the original members of the company must **sign their name** to the Memorandum of Association, thus confirming their subscription to the Company. This contrasts with the case of the wording used to establish the formation of **partnerships en nom collectif** and **en commandite**, since the Law requires that the partners to such partnerships **enter into and sign** the partnership deeds which constitute the respective partnerships.

One must note that the Companies act contemplates the possibility of the M&As being drawn up **either by a public deed or else by a private writing**, provided that such document is enrolled in the records of a notary public. In such cases, an authentic copy must be forwarded to the Registrar of Companies in lieu of the original

A company comes into existence on the day it is registered in the MBR (Malta Business Registry). There is a small exception to this - in the documentation presented to the MBR, it may be stated that the Company will be authorised to commence trading at some future definite date. However, if the documentation does not contain such reference to future commencement, then the company is deemed to commence as at the date of registration. The company will keep on existing **perpetually and indefinitely**, until the **company is struck off the registrar, as per article 4(4) of the Companies Act;**

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 striking off of a company is equivalent to the death of a natural person, in that it **ceases to exist**. The main point to mention is that **as a rule, in the period before the striking off of the company, there will be a period during which the company is in liquidation.** There will thus be a point in time, in such period of liquidation, when the company is **dissolved**.

The role of the liquidator in a liquidation is very important, for a number of reasons;

1) The liquidator actually **takes over the management of the company from the board of directors**.

2) To **ensure that over a period of time** and as soon as possible, the **business of the company is**

wound up - meaning that when a liquidator is appointed, his intention cannot be to continue to

run the business, but rather to ensure that the company is wound down by a certain point in time.

3) To **take stock of all the assets and liabilities of the company** and to handle all business relations had by the company.

4) To **use the assets of the company to pay off the liabilities of the company**.

This fourth point is of pivotal importance. If the company is **solvent** (i.e - its assets are sufficient to pay off all liabilities), then there are no problems. If a company is **insolvent**, on the other hand,

several problems emerge, with the most pressing one being the **determination of which creditors are to be paid, and which creditors are not going to be paid**. This decision is not taken by the company itself - the first consideration to make is whether the creditors have some hypothecation or privilege in relation to their credit. In this case, those creditors are paid first. If all the creditors are the same, then the assets of the company will be split **pro rata** to the creditors according to their debt. Thus, a company owning 1,000,000 of assets will pay only half of their debts to the company's creditors, if such creditors are together owed 2,000,000. Thus, it is not a case of *some creditors will be paid while some won't,* but rather the company will pay a portion of the debt to the best of their ability according to the assets owned by such company in relation to the debts owed to creditors. In the case where there are creditors protected by hypothecs or privileges, these creditors will be paid in full.

Registering a Company

In principle, to register a company, you must;

1) **Draft a M&A** and have it signed by the **original subscribers** to such M&A;

2) Submit a **deposit slip** usually issued by a bank or a CSP(Company Service Provider), which will show the **initial share capital of the company** as having been deposited with the bank or with the CSP if the initial share capital is deposited with such CSP. The initial share capital refers to the initial issued paid up share capital of the company. If you have an issued share capital of 100,000 EUR, divided into 100,000 shares of 1 EUR each, 10% paid up, then 10,000 EUR is to be deposited in the bank or in the CSP;

3) The **registration fee** which is payable to the **registrar of companies**, which is linked to the authorised share capital of the company.

For the standard incorporation of a company, you can go to the MBR with a signed M&A, with the deposit slip, and with the registration fee, and you will be able to set up a company. However, there may be circumstances which could serve to **delay** the starting up of a company. For instance, if a shareholder is in the UK and is required to sign the M&A directly, then the shareholder may either delegate his power to appoint someone to sign in his name (mandate), or else he will have to be sent the M&A for him to sign and send back to the registrar. Further, if the shareholder is a non-EU citizen, then further formalities and documentation is required.

One last thought is that it is one thing to have just one shareholder but if you are going to have 4 shareholders holding the shares in a company of same or different proportions, it would be good if there is time spent in drawing up M&A's of a company which shareholders will use to cater for different situations to be safe.

Further requirements for Public Companies - Art 69 (2)

All the formalities required for the formation of a private company apply **mutatis mutandis** to the formation of public companies. However, public companies face **further requirements** which private companies are not bound by. Thus, the registration of public companies faces more requirements than the registration of private companies.

Primarily, the Companies Act requires that there be annexed to the Memorandum of a Public Company;

- The **total amount or an estimate of all the costs payable by the company or chargeable to it by reason of its formation** up to the time its business commences;

- **A description of any special advantage granted prior to the time the company commences** its business to anyone who has taken part in the formation of the company or in transactions leading up to such business;

Another formal requirement in relation to the registration of a public company is that a person shall **not be capable of being appointed a director of such company unless he has personally, or through his agent authorised in writing, either signed the Memorandum indicating his consent to act as a director or has otherwise signed and delivered to the Registrar for registration a consent in writing to act as a director**. This requirement is not present in the case of directors for private companies. Here, one may argue that the legislator has tried to impose on the public company a **higher degree of formality** given the more widespread shareholding expected to be involved in a public company, as argued by **Prof Muscat**. Another reason could have been to highlight the **stress and responsibility required** to serve as a director for a public company, which is often significantly larger in scale than a private company. English law does not distinguish between private and public companies in this respect - consent is required to be delivered to the UK Registrar independently of whether the company is public or private.

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Ultra Vires

We split this into 2 - **ultra vires on the part of the Company** or **ultra vires on the part of the directors**. With regards to the first, we refer to situation when a Company carries out a transaction which **falls outside the objects of the Company**. With regards to the second, we refer to those instances where there is ultra vires on the Part of the Director, that is, what happens if a transaction carried out by the Company falls outside the powers of the directors. The issue here is to question whether such transactions remain binding on the Company. The situation whereby an act falls within the objects of the Company but falls outside the scope of the directors' powers is referred to as **acting ultra vires**.

The easiest way to deal with these issues is by analysing, in detail, **article 137 of the Companies Act**, in particular sub-articles 4-6.

137. (1) Every public company shall have at least two directors.

(2) Every private company shall have at least one director, and where a private company has one director, all references in this Act to two or more directors shall be construed as references to such one director.

(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.

(4) Notwithstanding anything contained in the memorandum and articles of association relating to the manner in which the representation of the company is to be exercised, **anything done by the board of directors of a company which exceeds the limits of their authority or by any director which is beyond his powers, shall be binding on the company unless that act exceeds the powers granted to the board of directors or to a director**, as the case may be, by virtue of this Act.

(5) Any limitation on the powers of the board of directors or of any director of the company shall not be relied on as against third parties independently of whether that limitation, published or not, arises from the memorandum or articles or from any resolution of the general meeting or from a decision of the board of directors of the company.

(6) Where an act of the company falls outside the company's objects, the company shall not be bound if it proves that, when the act was done, the third party **knew** that it was outside the company's objects or the third party could not in view of the circumstances have been unaware thereof:

Provided that the publication of the memorandum and articles of the company shall not in itself be sufficient to prove that the third party **knew, or could not have been unaware**, that the act was outside the company's objects.

(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.

(8) A person appointed by the court in accordance with the provisions of sub-article (7) shall hold office until the next annual general meeting although he shall be eligible for re-election.

(9) The provisions of sub-article (7) shall furthermore be without prejudice to the provisions of article 140(1) to (5) and of article 214(2)(*b*)(ii) and to the right of the company to fill any such vacancy in general meeting.

Prof Muscat holds that the concept of Ultra Vires is founded on the idea that a company is established for a specific purpose. It is clear that anything done by the Board of Directors of a

Company which exceeds the limits of their authority, or by any director which is beyond his powers, is binding on the company unless such an act exceeds the powers granted to the Board of Directors or a Director **by virtue of the Companies Act**. In reality, the Board of Directors have a large set of powers, **so it is not likely that a transaction will exceed authorit**y. Nonetheless, it is still possible.

In the instance that the Board of Directors are restricted in their powers, they cannot benefit from such restrictions vis-a-vis third party transactions - the law always seeks to protect the vulnerable party.

Where an act of the company falls outside the Companies' objects, the company is **not bound** if it proves when the act was done, that the third party knew it was outside the Companies' object, or the third party could not in view of the circumstance unaware thereof. Provided that the publication of the M&A is not in itself sufficient to prove that the third party knew or could not have been unaware that the act was outside the Company's objects. This onus of proof on the company is rather heavy.

The courts have also discussed the good and bad faith of the party dealing with the company. Sub articles 4 and 5 are silent on the matter and don't say the party knew or should have known. Good faith and bad faith do not feature like they do in sub article 6. Importantly, any powers decided by the

directors through a resolution are not public so how can one act in bad faith without knowing what the directors decided amongst themselves.

In relation to the first type of ultra vires, that of a company exceeding its objects clause we can look towards English judgments, like that of;

Ashbury Railway Carriage and Iron Co Ltd v Riche

In this case the objects of the company were to make and sell or lend on hire railway carriages and clause 4 of the M&A stated that activities beyond this object needed a special resolution.

In this case the company agreed to give riche and his brother a loan to build a railway in Belgium. The company later revoked the agreement, and the defendant sued, arguing the agreement was valid. **The company defended on the basis that the agreement was *ultra vires*** (beyond its legal capacity). The Ashbury case is a landmark judgement as it was the first that dealt with the ultra vires doctrine.

The **House of Lords** ruled that:

1. The company could not undertake activities outside its stated objects clause unless expressly authorised.

2. Any act beyond the company's defined objects was *ultra vires* and therefore void, even if all shareholders consented.

3. This interpretation protected creditors, who contracted with knowledge of the company's stated business activities and risks.

Consequences:

1. Protection of creditors: Creditors were presumed to understand the company's objects and risks. However, unsecured creditors lacked practical recourse, unlike secured creditors, who could seek legal protection.

2. Exhaustive Objects Clauses: Companies began drafting extensive objects clauses to avoid the *ultra vires* doctrine, leading to "exhaustive list syndrome."

3. Judicial Interpretation: Courts used rules like the *ejusdem generis* and the substratum rule to interpret objects clauses narrowly.

This case implies a strict adherence to the ultra vires rule, interpreting the objects clause very restrictively to the extent of impracticality.

Parke vs Daily news limited, decided in 1962. In this case the company sold its business and the company had also decided to pay 1 million pounds to the former workers as a thank you. One of the shareholders filed an action against the company for such payments and the shareholder agreed that such payments went beyond the objects of the company. The HOL decided in favour of the shareholders.

The rigid *ultra vires* doctrine was later softened in **Attorney-General v Great Eastern Railway Co. (1880)**, where the court held that activities incidental or consequential to the stated objects could be valid. This marked the beginning of a more flexible approach to interpreting corporate capacity, reducing the *ultra vires* doctrine's impact.

Today, the ultra vires rule is no longer relevant in the case of most English Companies, precisely because today, by way of the English Companies Act, a Company is no longer required to list its objects upon creation. Creditors and shareholders are protected through other mechanisms, such as directors' fiduciary duties and statutory protections under the Companies Act 2006.

The transition of the ultra vires doctrine in UK company law reflects a movement from rigid protectionism toward pragmatic flexibility. Early cases such as *Ashbury Railway Carriage v Riche* adopted a strict interpretation of the objects clause, rendering acts outside corporate capacity void. By contrast, *Royal British Bank v Turquand* did not relax the doctrine of ultra vires but mitigated its effects by protecting third parties from undisclosed internal irregularities once an act fell within the company's objects.

The situation in the UK is completely different today because in England the **2006 Companies Act,** no longer requires an objects clause when a company is formed. This is not the same position in Malta. Under UK Law, a radical change in interpretation occurred vis-a-vis the application of the ultra vires rule in relation to third party protection. Under the older regime of English Case law, the third party was being safeguarded in a manner which was prejudicial to the Company.

Again we should stress that under Maltese law, the company is not bound by an act which was done ultra vires its objects if it proves that the other party knew or given the circumstances could not have not known that the act was beyond the objects od the company.

The concept of ultra vires in relation to the objects clause under Maltese law safeguards third parties a little bit more than under English law for the same reason that constructive notice does not apply under Maltese law because article 137 (6) of the company's act in its proviso clearly states that third parties aren't required to refer to their M&A to see what the objects clause of the company are. Having said that they solved this problem under English law because the company's act of today does not require companies to list their objects clause.

Mahoney vs East Holyford Mining Company.

Here there is the concept of **constructive notice** which means that the court states that the third party could have easily relied on public documentation to see whether that particular act falls within the remits of the objects of the company or otherwise

The court said that the M&A is open to anyone and therefore it is up to the person to read this M&A and also to understand and see the objects of the company. This thus represents a strict approach that makes life more difficult for third parties transacting business.

As we know there could be other scenarios **where there is ultra vires** such as when the act is within the objects clause but is **beyond the powers conferred onto directors or any other representative of the company.** What is of importance is that in this case such acts can be ratified by the members. So, **Article 137 of the Companies Act** regulates what happens when directors act beyond their powers but still within the objects clause of the company. From a reading of **Article 137 (5) of the CA,** it appears that the legislator does not apply the **good faith principle** when an action is **ultra vires on the part of the director,** in that it is irrelevant whether the third party knew or did not knew of the director's limitations.

Dr Anthony H Farrugia noe vs Vernie Carbone pro et noe

CoA 30th May 2001

The alteration made to the Objects Clause of the company's Memorandum of Association by the above-mentioned Extraordinary Resolution was, in practice—perhaps correctly—carried out at the insistence of the creditor bank so as to eliminate all doubts that might arise. The Court, however, is of the view that these "guaranteeing powers" are intra vires the powers of any company which has a general clause in its Objects Clause similar to that existing in the Objects Clause of this company: "To do all such other things as may be deemed incidental or conducive to the attainment of the above objects or any of them." (Clause (k) of the Objects Clause of the company "The Orangery Limited"). In his examination of the Objects Clause in the above-mentioned book, **Professor Cremona** states that Objects Clauses readily include, among other things, "a concluding paragraph authorising the company to do all such other things as may be incidental or conducive to the attainment of the company's objects or any of them." In this regard he therefore maintains: "In this connection, however, one should keep in mind that **whatever is necessary to do with a view to attaining the stated objects or whatever else may reasonably be regarded as incidental or conducive to the said objects need not be specifically mentioned**, in that such acts are implied and to a great extent covered by the concluding paragraph above referred to." (at page 75).

Examination of Ultra Vires in English Law during our Commercial Ordinance

Later in the same book he examines the theory of ultra vires in English doctrine. He states that any obligation assumed by a company is ultra vires that company **when such obligation is not authorised by the Objects Clause;** whereas it is intra vires the company but ultra vires the directors when the representation in respect of the act in question is not in accordance with what is stipulated in the Memorandum and Articles. **In the first case the obligation is null and cannot be ratified; in the second case it is also, in the majority of cases, null, but may be ratified by the members of the company.** While he maintains that this theory is also applicable to companies formed under the 1962 Ordinance, there is, according to him, an essential distinction: "On the other hand, a company created under the 1962 Ordinance, being a legal person, has a capacity which is virtually unlimited and may alter its Memorandum and Articles at any time by an extraordinary resolution; hence, even where a contract or similar act is 'ultra vires' the company, such contract or act would be capable of ratification by an extraordinary resolution of the company in general meeting." This explanation, in the opinion of the Court, is relevant to the present case.

iii. Finally, on this point, this Court makes reference to what will be stated later in this judgment with regard to the English case **Royal British Bank v Turquand**, which, perhaps in a limited manner for

the purposes of this subject, may also find application even where a case is being dealt with under company law regulated by the 1962 Ordinance.

The legal issue arising from this problem was examined in the English case cited by the defendant bank in its submissions at first instance, namely **Royal British Bank v Turquand**. The rules established in this case were seriously restricted in more recent judgments; however, none of these restrictions apply to the present case. The English author **Gower** thus comments on this case when examining it in relation to the theory that any creditor had the obligation to verify the powers of the company and its representation insofar as these could emerge from an examination of the Memorandum and Articles of the debtor company:

"In the circumstances one might reasonably have supposed that a third party, who was bound to read the deed, would be put on enquiry to see that the requirements of the deed had been fulfilled. On the contrary, it was held that since, under the deed, the Directors might have had authority, **the third party was entitled to assume that in fact they had it**." (*Gower's Principles of Modern Company Law*, 4th Edition, 1979)

In ***Pennington's Company Law*** (4th Edition, Butterworths, 1979), the author considers the application of the rule in **Turquand's case** under three aspects:

(a) the defective appointment of a director, or a director continuing to act for the company after he ceased to be a director;
(b) failure to hold a properly convened Board Meeting to authorise the company to enter into a transaction; and
(c) a disregard of the limitations imposed on directors' authority by the Memorandum or Articles.

Fil-kaz in ezami huwa rilevanti dak li jghid dan l-istess awtur a pagina 124 ta' l-istess ktieb: "**The reason why the rule protects the outsider in these cases is that <u>he has no means of ensuring that the conditions or the procedure prescribed by the Memorandum or Articles have been adhered to."</u>**

Referring back to **Article 137 (6)** of the Companies Act, it is clear that where an act is exercised *ultra vires*, the Company is not bound by that transaction if it is proven that the third party was

aware or could not have been unaware of the limitations to that transactions. The onus of proof lies on the Company to prove that the third party knew of the restrictions on the Company vis-a-vis the objects of the Company. The Turquand's rule, thus, is only effective where there is a **procedural defect** by the party transacting with the third-party vis-a-vis the memorandum.

The reasoning is that since the third party has no access to the internal functioning of a Company, he is able to reasonable rely on the fact that the internal procedure is being adhered to.

137. (6) Where an act of the company falls outside the company's objects, the company shall not be bound if it proves that, when the act was done, the third party knew it was outside the company's objects or the third party could not in view of the circumstances have been unaware thereof:

Provided that the publication of the memorandum and articles of the company shall not **in itself be sufficient to prove that the third party knew,** or could not have been unaware, that the act was outside the company's objects.

In summation, if the act is ultra vires the objects clause of the company, then the act is binding only unless the Company proves that the third party was acting with the knowledge that the Company was acting ultra vires of its objects.

John refalo vs Eleanora sive Leah refalo sive bartolo

In this case the husband and the wife entered into a contract of personal separation and as part of the agreement the plaintiff company granted usufruct of a flat on a gratuitous basis for life to the wife, the defendant in this case, on the condition that she does not marry or cohabit with another man in the flat. The plaintiff company filed an action against the defendant, trying to evict her stating that she breached this condition. She tried to allege that this cannot be a contract signed by the company because it is ultra vires to the objects of the company**. The court concluded that although it can seem ultra vires, the usufruct was in the best interest of the company and was allowed in the wide wording used in the objects clause of the company.**

Other English judgements have adopted a wider definition of the objects clause and one important case in this regard is the ***Royal British Bank vs Turquand*** (Turquand rule – indoor management rule) and held that people transacting with Companies are entitled to assume that internal company rules are complied with even if they are not. Mr Turquand was a liquidator, and there was a particular rule that required that a particular bond under the Companies' seal had to be signed by 2 directors and the secretary. What is relevant from this case is that when the company was sued it alleged that under its registered deed of settlement (M&A) directors only had power to borrow up to an amount authorised by a company resolution**. The Court deemed that this resolution dealt with the internal affairs of the company and a third party cannot be negatively impacted by such a rule.**

Homes of Quality Limited vs Lawrence Fenech Ltd

FHCC 28/05/2015

Good faith is essential to working with the Turquand rule *"Jibqa il-fatt li d-dokument… kellu jigi iffirmat minn zewg diretturi biex jkun validu u* ***sabiex document iffirmat minn direttur wiehed jkun jorbot il-kumpanija, kellu jigi pruvat illi kien hemm buona fede tat- terz****. Fil-fehma tal-Qorti, din il-buona fede ma gietx pruvata."*

The Court also said, applying the **Turquand Rule correctly, that it is intended to protect a 3rd party from internal affairs which are not ascertainable**. However, the court held that since a representative of the plaintiff company was present during the signature of the preliminary agreement, she could have observed that 2 signatures were required. Courts seldom need to rely heavily on the Turquand Rule to protect third parties, as the provisions in the Companies Act and the Court's application of mandate principles already offer robust safeguards. The general rule is that any limitation on directors' powers, whether arising from the M&A or a resolution, cannot be used against third parties. Judicial decisions have established a balance whereby, as much as possible, the validity of acts is preserved. For instance, if a third party enters into an agreement with an unauthorised individual acting on behalf of the company, the company cannot invalidate the act unless the third party knew the individual lacked authority. However, if such knowledge is proven, the act would be null and void, as illustrated in ***Salvatore Schembri et vs Salvatore Gauci et noe***

The Turquand Rule aims to shield third parties from the internal affairs of a company rather than protect the company itself. A third party cannot use the company's failure to comply with its M&A as a defence, given that the M&A is a public document accessible for inspection. If a third party is aware

of non-compliance at the time of ratification, their right to object may be deemed waived. Conversely, if unaware, their conduct may, under certain circumstances, be interpreted as ratification, as guided by **Civil Code Articles 1227–1230.**

Ultra Vires on the Part of the Director

Regulated by 137 sub articles 4 and 5 of the company's act which again is based on the first EC directive. The first question that one may ask is what are the powers of the directors arising out of the Companies Act. Effectively the court of directors enjoys **any residual power of the company** which means that the company's act says that any power not vested in the shareholders is vested in the BOD. However, having said that, in this scenario, keep in mind that the wording of the law does not mention any good faith or bad faith of the third parties as is mentioned under sub article 6, although there are some judgements that have decided otherwise.

Referring to the situation of **ultra vires on the part of the director** (i.e. where an act falls within the objects clause but externally to the directors' powers), we may refer to **article 136A (3) (e)**, which holds that the directors are bound to exercise the powers they have for **the purposes for which the powers were conferred**. Here, we speak of a misuse of powers. Where the director fails to remain within the scope of his duties, or where he misuses his powers, he is **personally joint and severally liable with all other directors for any damages which may arise**.

Distinction between director not within scope of his duties as opposed to misusing his powers?

136A (3) In particular, but without prejudice to any other duty assigned to the directors of a company, or to any one of them, by the memorandum or articles of association or by this Act or any other law, the directors of a company shall:

(*e*) **exercise the powers they have for the purposes for which the powers were conferred** and shall not misuse such powers.

137 (4). Notwithstanding anything contained in the memorandum and articles of association relating to the manner in which the representation of the company is to be exercised, **anything done by the board of directors of a company** which **exceeds the limits of their authority** or by any director

which is **beyond his powers**, shall be **binding on the company unless that act exceeds the powers granted to the board of directors or to a director**, as the case may be, by virtue of this Act.

(5) Any **limitation on the powers** of the board of directors or of any director of the company **shall not be relied on as against third parties** independently of whether that limitation, published or not, arises from the memorandum or articles or from any resolution of the general meeting or from a decision of the board of directors of the company."

147. (1) The personal liability of the directors in damages for any breach of duty shall be **joint and several:**

Provided that where a particular duty has been entrusted to one or more of the directors, only such director or directors shall be liable in damages.

(2) A director shall not be liable for the acts of his co-directors if he proves either -

(a) that he **did not know of the breach of duty** before or at the time of its occurrence and that on becoming aware of it after its occurrence he **signified forthwith to the co- directors his dissent in writing;** or

(b) that, knowing that the co-directors intended to commit a breach of duty, **he took all reasonable steps to prevent it.**

As a juridical person, a company acts through its directors, whose authority is limited to ensure that

the company's objects are pursued in accordance with proper legal and procedural channels. Directors cannot engage in acts that are ultra vires the company, disregard limitations imposed by the company's Memorandum and Articles of Association (M&A), or ignore instructions set out in a general meeting.

This framework is **designed to balance the interests of third parties with the internal governance of the company**. Articles 137(4) and (5) of the Companies Act reinforce this balance by ensuring that a company cannot evade liability by claiming that a director acted beyond their authority, except in cases where the act is ultra vires the company, as specified in Article 137(6), **provided it may prove the third party's awareness.** The law, supported by judicial creativity, strengthens third-party rights while holding directors accountable within the established legal limits. In practice, individual directors hold limited power, with their authority becoming significant only when they act collectively

as a board. If an individual director exceeds the powers granted ***under the Companies Act***, the company can invoke **Article 137(4),** which implies that such acts are not binding on the company.

Moreover, if directors, whether collectively or individually, cause losses to the company by entering into transactions that bind the company under Articles 137(4) and (5) but exceed their powers under the Memorandum and Articles of Association (M&A), such actions constitute a breach of fiduciary duties. In such cases, directors may be held liable for damages resulting from their misconduct.

Edwin Zammit v Group 9 Limited et al.
Court of Appeal, 16 February 2004

14.Even on the hypothesis that one were to accept that there was no such authorisation by the Board, this Court is nevertheless of the view that the deed of 12 October 1995 binds the defendant appellant company, because the teaching drawn from ***The Principles of Modern Company Law*** **by L.C.B. Gower** and cited in the judgment of the court of first instance remains applicable under the regime of the 1962 Commercial Companies Ordinance. Certainly, a third party who deals with a company has the duty to consult that company's public documents when he is about to negotiate with it**. Now, in the present case, the statute of the appellant company permitted a single director to represent the defendant company and bind it vis-à-vis third parties, provided that he was authorised to do so by the Board.**

When Raymond Mifsud presented himself as a director representing the appellant company on the deed in question, **the plaintiff Edwin Zammit was fully entitled to assume that that director had duly complied with the internal regulations of the appellant company**. This is all the more so when Raymond Mifsud not only appeared and signed on behalf of the defendant appellant company, but on that occasion also paid the considerable sum of two thousand three hundred lira (Lm 2,300) to Edwin Zammit. It is a basic maxim of civil law that contracts must be performed in good faith, and it is also an important procedural maxim that *omnia praesumuntur rite ac solemniter esse acta*. **For this latter presumption not to apply, it must be proved either that the third party was well aware that the director in question did not have the authorisation required by the internal regulations of the company to bind it, or else that there existed particular circumstances which ought reasonably to have aroused suspicion in that third party that the director was not duly authorised to bind the company.**

Consequently, this Court, like the court of first instance, finds that when Raymond Mifsud signed the deed of 12 October 1995 in the name and on behalf of the appellant company, **he was legally and**

validly binding the appellant company by the contents of that deed. Consequently, the ground of appeal raised by the appellant company is unfounded and cannot be upheld.

Avukat Dr Pio M.Valletta noe vs Jeno Torocisk et,

FHCC, 07/10/2016

This case concerned a minority shareholder under **Article 402's** unfair prejudice action claimed that a particular contract was executed by a director who acted *ultra vires* under the M&A. In this case, the companies M&A allowed a very general power to the director to the effect of allowing him to transact, manage and do anything ancillary with the objects of the company. The Court, with this general provision, **found no breach of *ultra vires.***

"What remains a problem is the situation where a third party deals with an individual director whose authority to act on behalf of the company is disputed ..... For a third party to be able to hold the company to a transaction where he has dealt not with the board but with an individual director, officer or employee, it will be necessary for the third party to show that the individual with whom he dealt had authority, actual **or ostensible**, to bind the company in this way. Actual authority may be expressed or implied authority: express, arising from an explicit conferring of authority on a director, perhaps in the articles of association implied, arising from the position which the individual holds. **Ostensible or apparent authority, on the other hand, is the authority of an agent as it appears to *others."***

- Company Law, **Farrar's**, Third Edition

"**Where the person through whom the third party dealt occupies a position in the company such that it would be usual for an occupant of that position to have authority to bind the company in relation to the transaction concerned, the company will be bound.** The third party dealing with the company in good faith **will be entitled to assume that that person has authority unless he knows the contrary or knows of facts which would have put a reasonable person on inquiry**. Thus if the person acting for the company is its chief executive or managing director, then, despite the fact that the Act refuses to treat him as an organ of the company equivalent to the board of directors unless there are suspicious circumstances, or the transaction is of such magnitude as to imply the need for board approval, he may safely be assumed to be authorised. In practice, he will probably have actual authority but, even if he has not, he will have ostensible authority and his acts will bind the company.

- **Gower's** Principles of Modern Company Law, Sixth Edition

"**It is suggested that the type of representation clause considered by the Court in that case, could, in appropriate circumstances, justify a conclusion binding the company to the agreement signed on its behalf**. Such a conclusion could be based on an approach linking tacit authority with the representation clause. Three conditions would however need to be satisfied for such an approach to be adopted: **first** that the representation clause must be such as to empower the board to authorise any person to represent the company; **second**, that the clause must not require such authorisation to be given in writing; and **third**, that the person signing the agreement on behalf of the company must have at least tacit authority to act on behalf of the company."

Fil-kaz li ghalih kien qed jirreferi l-awtur imsemmi, **Scicluna v Tabone** l-articles of association fdaw ir-rapprezentanza tal-kumpanija f'idejn ic-Chairman "or to such other person or persons deputed and authorised for the purposes by the Board of Directors."

Il-Professur Muscat jkompli:

"Where, on the other hand, the contractual representation clause is drafted on the basis, for example, that documents purporting to bind the company are to be signed by 'any two directors or by any person or persons authorised by the board for the purpose' then any mandatory appointed by the company in terms of the articles should also be deemed to be entitled to sign documents on behalf of the company."

- Prof Andrew Muscat

The Companies Act holds no answer as to whether a transaction can be challenged by a third party. Generally speaking, today, the number of cases on the grounds of ultra vires are being reduced, because the objects clause of the Company today are being drafted very widely.

Therefore, when the director acts ultra vires of his authority, but intra vires the Companies' Objects, then the Company is still bound to the transaction. The remedy which may be sought by the Company is to institute a claim for damages against the director who would have acted outside his powers.

Deidre Cachia et vs Gava diamonds limited, 2003

In this case the court said that if there is ratification by an extraordinary resolution of the company in a GM accepting those agreements then the company would have then lost the possibility to sue any party that would have signed on behalf of the company.

Furthermore, per article 137 (4), if the directors' act falls in breach of the Companies Act, then the transaction is null and void, irrelevant of whether the third party knew or not of the breach of his powers.

These principles tie into the essential concept of the Turquand rule, in that while a third party may consult the published documents of a company, he is not obliged to verify compliance with internal requirements, and cannot suffer any negative consequence due to non-conformity by the company's representatives with the Memorandum and Articles. **Thus, the third party in good faith may enforce the transaction if the person with whom he has transacted has presented himself to be acting within his powers, when in fact he was not. The Company is bound, but then it may seek damages against that director.**

However, having said that, in this scenario, keep in mind that the wording of the law does not mention any good faith or bad faith of the third parties as is mentioned under sub article 6, however, there were court judgements that decided otherwise

Catherine galea vs Milika micovic nomine decided on the 19th November 2001, 271/1993/1.

In this case the plaintiff said she entered into a POS in 1991 which was extended to march 1993. Both the POS and the extension were signed by the plaintiff and the defendant company which means that prima facie the defendant company obliged itself to sell and transfer the temporary lease that still would have run on that particular property.

Catherine filed this action because at one point in time the defendant company did not want to honour this POS and extension. The plaintiff company said this extension was not signed by 2 directors which was required by the company and the FHCC stated that the plaintiff's father was the auditor of the defendant company and it was his duty to inform her that the extension must be signed by 2 directors. **The POS was signed by 2 directors but the extension was only signed by one**. The court said that

the plaintiff knew or ought to have known that the extension should have been signed by 2 which meant the extension was invalid and the POS expired because the defendant company did not have the obligation to transfer the property.

Minority Shareholder Actions

Majority Rules refers to the power that can be manifested or held by those who own more than half of the shares with voting rights assigned to such shares. One is classified as a majority when his/her shares are significantly higher than the other shareholders. Such majority members would have voting rights assigned to their shares, which ultimately leave them with the final say in any decision taken during a general meeting.

The minority must, either accept the decision taken at general meeting via majority vote **or seek to appeal or reverse such decision by democratic means available to them.** That of persuasion, lobbying or selling their shares and investing elsewhere. However, the democratic means available may be useless and ineffective remedies to any wrong done by majority if such wrongdoers are in power or control.

Selling one's shares could also be difficult or reap unjust results, especially if there are a number of clauses in the company's M&A restricting the sale of one's shares; or possibly due to the fact that the wrong done by those in control, has had a negative effect on the value of shares of the company. Majority's control over minority via their votes in general meetings could be classified as **direct control.** However, majority may also exercise **indirect control** through board meetings. Directors appointed to the board are generally appointed by the shareholders. The management of the company could be vested in the directors of the company. Directors are bound by duties stipulated in the law, and along with the shareholders, are to act in a *bona fide* manner and for the benefit of the whole company. However, majority shareholders may use this power via directors to act in their own selfish interests, whether they are consistent or otherwise with those of the company.

There are also a number of clauses that may be put in place within the company's M&A which may provide further protection to minority shareholders, such as tag along provisions

or different class rights. Protection from any potential or actual prejudice may also be provided via private shareholder agreements.

When a minority shareholder would like to resolve an issue pertaining to him, the first thing which he ought to do is to refer to the M&A, t**o check whether any forms of protection is contained in his favour**. When entering into the shareholding of a business, the shareholder is to make sure that the M&A offers him sufficient protection against any potential exclusion of his say in light of the fact that he is merely a minority shareholder. He might consider different classes of shares, he may contribute to any reserved matters, he may refer to the voting rights, all of which are contained in the M&A. These safeguards serve to protect minority shareholder. When a minority shareholder claims that he is being abused by the majority, the first point of reference should be the M&A. The second line of defence is to see whether the Companies Act provides any tools to combat such abuse and to protect the minority shareholder. The Companies Act in fact has a number of sections which serves to protect the minority shareholder. The main form of direct protection is that of **article 402**. Besides this provision, the Companies Act provides for other forms of protection;

Secondary Provisions of Protection

There are, however, other forms of protection in the Companies Act, such as **Article 81**, which states;

> **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 o**f, 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.

This provision holds that no shareholder may be compelled to increase his shareholding in the

Company. This Article is not all protecting, since if other shareholders want to increase the share capital, then while it is true that a shareholder cannot be compelled to purchase more shares, the other shareholders are free to call more shares, purchase them, in turn diluting the shareholding of those shareholders who do not wish to purchase more shares. To remedy this, to issue more shares, the Companies Act requires an extraordinary resolution to be passed. However, if the extraordinary resolution may be passed by the majority shareholding, then the minority shareholding may be diluted at will. However, **if the M&A requires the consent of the minority shareholders to issue new shares, then this dilution at will is not possible.** This is why the M&As are pivotal in ascertaining the protection of the minority shareholders.

Another article giving protection is **article 131,** which speaks of the right of every shareholder to receive the notice of the General 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.

Very often, however, the M&As are drafted in such a way that the accidental omission shall not invalidate the proceedings of such meeting, in turn rendering this article obsolete. Article 34 of the First Schedule speaks of an accidental omission to give notice, and thus **it is in the shareholders' interest to exclude article 34 of the first schedule from the M&As upon**

their signing and drafting. Another protective article is **article 129**, which speaks of the convening of extraordinary general meetings upon the request of at least 10% of the shareholders of the Company, after which request the directors must convene the meeting within 21 days.

Another article is **article 132**, which says that if it is impractical to conduct a meeting of the Company, the Court may, either at its own motion or at the demand of a member, or of a director, duly convene a meeting. Thus, if a majority shareholder is reluctant to convene meetings, then by article 132, a minority shareholder may convene such meeting. **This provision may be used when, for instance, majority shareholders refuse to attend meetings, thereby ensuring that a quorum is not being attained**. The Court may direct the shareholders to hold the meeting ignoring the quorum.

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.

Further, **article 133** speaks of proxies, which holds that shareholders have rights to send proxies to meetings which they cannot attend. The use of proxies is convenient, because the shareholder may not be in a position to attend meetings, whether by illness, or even by reason of conflict and a desire not to face other shareholders directly.

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.

A proxy may be used even in those meetings which require some special expertise. So a shareholder might want to send a proxy well versed in a specific issue when the meeting concerns that issue, instructing the expert to act in his best interest. The law speaks of the appointment of proxies automatically in the case of shareholders. For directors and board meetings, however, the appointment of proxies may only arise if the M&As so provide for.

Another article is **article 137 (7).** In ***P.M.S. (Holdings) Ltd vs. X***, the Company had one director, who died. The heir of the deceased person did not decide whether to accept the inheritance or not. In turn the Company was deterring, facing penalties, among other sanctions. Eventually article 137 was invoked, which states;

137. (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.

(7) shall hold office until the next annual general meeting although he shall be eligible for re- election.

(8) A person appointed by the court in accordance with the provisions of sub-article

(9) The provisions of sub-article (7) shall furthermore be without prejudice to the provisions of article 140(1) to (5) and of article 214(2)(*b*)(ii) and to the right of the company to fill any such vacancy in general meeting.

Another important article is **article 151(4)**, which speaks of the appointment of an auditor, to protect the interests of the shareholders, to ensure that the accounting records being kept give **a true and fair view**, so that at the end of the year, when the shareholders discuss the financial statements and take stock of what happened in the previous year, they will have a true and fair view of what is going on in the Company. The legislator has catered for a scenario which holds that where the majority shareholders do not appoint an auditor, the minority shareholders may seek the Court demanding an auditor to be appointed.

151. (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.**

Another important clause is **article 161**, which states;

161. (1) Where an auditor ceases for any reason to hold office, he shall deposit at the company's registered office a statement of any circumstances connected with his ceasing to hold office which he considers should be brought to the attention of the

members or creditors of the company or, if he considers that there are no such circumstances, a statement that there are none.

This provision may be used when, for instance, as seen in the case of ***Valle del Miele***, in which a Company bought a new fleet of vans, and when during the purchase period, shareholders had purchased luxury cars from the same importer for their personal use, indicating a suspicious transactions, in which case the auditor may be called upon to investigate. The Auditor may cease to hold office, since he wants nothing to do with the suspicious transactions. **Before resigning, however, he must submit a statement of any circumstances connected with his ceasing to hold office, along with any pressing or urgent matters which affected his resignation**. This tool may benefit minority shareholders, since they may use this statement to their advantage, proving that prejudice was faced against the Company by reason of majority shareholders.

In a liquidation scenario, one ought to consider **articles 289** and **296 (3),** which also provide protection. More protection is found when a Company seeks to convert into a partnership. If a minority shareholder disagrees with the transition into a partnership, since he does not want personal liability, **article 330 may be invoked**, which holds;

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

Principal Provisions of Protection

Two other **major articles of protection** are **articles 214** and **article 402**. The former is referred to as the **just and equitable remedy**, while **articles 402** is referred to as the **unfair prejudice remedy**. Before delving into the two, we will first appreciate the philosophy of shareholder protection. Like in a democracy, there is a constant interplay between the notion of majority rule and the protection of minority rights.

History of Minority Shareholder Protection

The UK Case ***Foss vs Harbottle*** *(1843)* was echoed in the Maltese case ***Falla vs Sorotos*** *(Court of Appeal 12 March 1976)*. Both these judgements establish that the **minority have to respect the wish of the majority**. The issue then arises as to when the majority starts to abuse their power. What if directors do not act in the interest of the company? What happens if there is fraud on the minority? The rule of law, known as the rule in ***Foss vs Harbottle***, is described by ***Pennington*** as *one of which has resulted from the refusal of the courts to interfere in the management of a company at the instance of a minority of its members who are dissatisfied with the conduct of the company's affairs by its board of directors or by or under the discretion of members of the company who control a majority of the votes which may be cast at general meetings*. **Lord Justice Mellish** has interpreted this rule to the widest extent, in that if the majority are entitled to perform the acts which are being contested, then the minority must abide by such acts no matter what. The reasoning is that the Company itself, as a separate legal entity, has the right to file actions on alleged wrongdoings, and not the shareholders.

Foss vs Harbottle *(1843)* is made up of two limbs. The first is that if a wrong is done to a **company it is the company itself that has to decide whether to take action or not to protect its interests**. The second limb of this judgement holds that the decision of whether the Company will take action to protect its interests or not **is a decision that will be taken by the majority.** One will appreciate that the first limb is based on the notion of **separate legal**

personality, while the second is based on the notion of **majority rule**. This position remains firmly in place until 1950, as seen in ***Edwards vs Halliwell***. The problem with this philosophy is that if it is the majority who are themselves abusing, then naturally they will not want to seek the protection of the Company's interest. Thus, UK law provided for some exceptions to this philosophy;

1) When the transaction is **illegal** or **ultra vires**: the majority in a General Meeting cannot authorise the Company to act in a manner which is ultra vires or illegal.

2) When the transaction requires a special majority, then a simple majority cannot perform that transaction, as held in ***Edwards vs Halliwell.***

3) When the action of a company infringes the **right** of a **minority shareholder**, which means that the majority cannot override the personal right of a shareholder. The case ***Pender vs Lushington*** (1877) discussed this scenario, discussing the case where proxies (nominees) were not allowed to vote in the shareholder meetings, concluding that this amounted to an invasion of the rights of shareholders. Under Maltese Law, proxy voting is allowed, and so a breach of this right would give rise to an unfair prejudice action.

4) When there is **fraud against the minority**. The first case to mention in this regard is ***Atwool vs Merryweather*** (1867), wherein it was alleged that two directors made a secret profit by selling shares to a third party. The real nature of this contract was concealed from everyone. The Court concluded that this was equal to fraud, and thus the minority shareholders were given a right to file an action.

The personal right of a shareholder can arise both from the M&As and from a Shareholders' Agreement. There was a development in the UK, as evident in **Case 5136/1986**, where the Courts held that a breach of a directors' fiduciary duty, may give the shareholder a personal call for action. This right can then not be infringed.

The fourth exception to ***Foss vs Harbottle*** is the clearest exception to the rule. In this case, a derivative action may be brought by a minority shareholder himself for and on behalf of the Company, even though that minority shareholder is not vested with the judicial or legal representation of the company.

In order to bring a derivative action, 2 criteria must be satisfied:

1) Fraud is being exercised on the minority

2) The shareholder must establish **wrongdoer control**, which prevents the Company itself from bringing an action in its own name.

In order to propose a derivative action, the shareholder cannot be tainted in any way. The Court must be satisfied that there has not been any unreasonable delay in bringing the action. One must note that the success of this action will in no way benefit the shareholder personally, since all proceeds and all benefits go towards the Company. On derivative action one may confer with ***Towers vs African Tug Company*** *(1904)* ***and Nercom vs Nercom*** *(1985)*. In Malta ***Mixkuka vs Mangion*** demonstrated a use of the derivative action. Interestingly enough, the derivative action is questionable in light of article 402. In ***Debattista vs Debattista***, a whole debate arose as to the derivative action. One should note that this case is under circumstances where the laws prior to the Companies Act apply.

Debattista v Debattista

Commercial Court, 17 March 2023

The parties discussed extensively the nature of the action brought by the plaintiffs in these proceedings, and the Court considers that there is agreement — with which the Court also concurs — that this is an action brought by the plaintiffs in their capacity as **minority shareholders** in the company **Innag Household Limited**.

Some of the defendants maintain that the action is untenable and cannot be brought in the circumstances, and therefore the Court must examine whether the plaintiffs' action, as set out in the third and fourth claims, is sustainable.

Professor **Andrew Muscat**, in his book *Principles of Maltese Company Law*, refers to this issue in detail and primarily refers to the case **Michael J. Falla v John H. Sorotos**, decided by the Court of Appeal on **12 March 1976**, which concerned allegations made by shareholders similar to those in the present case, where the Court concluded

"An action against the directors based merely on breach of their duties qua directors (which they owe to the company) and no more, is in principle a social (and not an individual) action, directly flowing from the contract of partnership ('kuntratt tas-soċjetà') and exercisable by the company itself."

Accordingly, Professor Muscat explains that *"in respect of a wrong done to a company, it is the company — and only the company — that has locus standi as plaintiff. The shareholder has no juridical interest, and therefore no locus standi as plaintiff."*

Naturally, this conclusion creates a difficulty where the directors of the company who are acting improperly decide that the company should not institute legal proceedings challenging their own management

It is against this background that the **derivative action** must be considered. The Court of Appeal, in the judgment **Edgar Bonnici noe v Oliver Agius et noe**, decided on **6 November 1991**, concluded that a derivative action may be brought, but it must be proven that there was **wrongdoer control** which prevented the company itself from instituting the action, and it must be shown that the shareholder attempted to persuade the company to institute proceedings.

With regard to **wrongdoer control**, Professor **Andrew Muscat**, in the above-mentioned book, states:

"Wrongdoer control exists if the wrongdoer has a majority of the votes, or if the majority has in fact approved the wrongdoing, or if the company has otherwise indicated that it is not willing to institute proceedings."

Mixkuka v Mangion

The nature of the action was examined by this Court as differently constituted in its judgment of **23 April 2003**, although this was strictly within the context of the preliminary pleas, and at that stage the question whether an action of this nature could be brought against a company in the process of being struck off remained undecided.

It is true that Professor **Andrew Muscat** (op. cit., p. 891) maintains that:

"It should also be noted that the derivative action is not available when the company is in liquidation."

However, the Court is of the view that the **very particular circumstances** of this case — where the alleged "wrongdoer" is the same liquidator who, by law, is "in control" — justify a departure from this principle. During oral submissions, learned defence counsel raised doubts as to which law is applicable to the present case. This issue had already been raised and bypassed in the first judgment, where the Court held that:

"The law provides that a dissolution of a company which took place before, within six months of, or during six months from the established date continues to be governed by the provisions of the Ordinance (Chapter 168), and that any striking-off resulting thereafter should be regulated accordingly. However, the same article provides that if the name of the company had not yet been struck off the register of companies by 1 March 1998, the striking-off of such a company must, from that date onwards, be governed by the Companies Act, provided that an application is made to the Court to that effect. When one considers that, in the case of ***Cottonera Properties Limited****, the process of informal striking-off had not yet been completed when this action was instituted (in 2001, that is, almost nine years after it had commenced), this leads the Court to the view that it cannot be said that the said process is necessarily bound to and must be carried out solely in accordance with the provisions of Chapter 168."*

It was within this framework, therefore, that the Court proceeded to consider the other preliminary pleas. The **Commissioner of Lands** pleaded the absence of a juridical relationship with the plaintiff company. The Court considers that this objection cannot be upheld. The plaintiff company is seeking to rescind a contract to which the Commissioner himself was a party. If the plaintiff were to succeed in its objective, it would be the Commissioner himself who would be ordered to remedy the situation, and therefore he can never be excluded from proceedings of this nature. The Commissioner further objected that the action was procedurally irregular because it was not brought in the name of **Cottonera Properties Limited**.

In the opinion of this Court, these two objections cannot be considered valid, having regard to the nature of the action under consideration, as explained by Professor **Andrew Muscat** (p. 891, *Principles of Maltese Company Law*).

"In a derivative action, the minority shareholder is the claimant. He sues on behalf of himself. The action is brought against the alleged wrongdoers and the company is joined as a defendant. The requirement that the company, in whose interest the claim is brought, be included as a defendant is justified on the basis that only in this manner can it be bound by and benefit from the judgment. It has been remarked that it is 'highly misleading' that 'an action to enforce the company's rights takes the form, apparently, of an action against the company!' The reason why the company cannot be made a plaintiff is justified on the basis that neither the board nor the general meeting would have consented to it."

Therefore, the preliminary objections raised by the Commissioner of Lands are being rejected.

Prof. Muscat opines that there are clear advantages to the rule set out in *Foss* case - first it is more efficient for the company itself to sue in respect of a wrong done to itself rather than having a number of actions filed by the various members. Second, it avoids litigation where the majority can pass a resolution approving the alleged wrongdoing. Third, it reduces the risk of vexatious suits being filed by minority shareholders attempting to badger the company We have seen how the situation developed in the U.K.

Under Maltese law, the situation started off with the adoption of ***Foss vs Harbottle***, lock, stock and barrel. Besides Sorotos, there was ***Pace vs Bonello*** (1996), ***Martin Bonello co vs Kenneth Cole*** (2001), and ***Tabona vs Grech*** (1980). Until 1995, there was no ad hoc remedy, because the Companies Act was enacted in 1995, and thus there was no article 402 to rely on. We had the Commercial Partnerships' Ordinance, which did not have an ad hoc remedy for the protection of minority shareholders. Thus, some judgements started giving us exceptions to the rule.

Falla vs Sorotos

Court of Appeal, 12 March 1976

Our courts have also had occasion to proceed in a similar manner to that outlined above where there is an allegation of **improper conduct by a director or directors of a company** which results in loss or is **prejudicial to a shareholder**, independently of the company itself. In the case styled **"M.J. Falla vs J.H. Sorotos"**, decided on 12 March 1976,

the Court of Appeal recognised such a **right of action**, inasmuch as it held that such allegations (the judgment being delivered in English), *"if substantiated, appear to entail a direct personal prejudice to the plaintiff as distinct from the Company itself (which the plaintiff says was composed of only two shareholders) …"*.

It follows, therefore, that *"the plaintiff does have a right of action vis-à-vis the defendant."*

By and large, 3 exceptions to the rule of majority rule have been adopted by Maltese Courts.

1) When there is fraud against the minority (***Tabona vs Grech*** *(23rd April 1980),* ***Edgar Bonnici Cachia vs Oliver Agius*** *(6th November 1991),* ***Meatland Company Limited vs Saviour Micallef*** *(12th December 2001)*, the latter of which held that the shareholder could institute a derivative action to protect the interest of the company).

Meatland Company Limited vs Saviour Micallef

In *Company Law* by **Mayson, French & Ryan**, it is stated that:

"The legal rights of a company belong to the company as a separate person and not to its members. The members of a company do not have standing to enforce its rights by legal action."

As explained by the Court of Appeal in **Prudential Assurance Co. Ltd. v Newman Industries Ltd. (No. 2)**, this is:

"an elementary principle that A cannot, as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C. C is the proper plaintiff because C is the party injured, and therefore the person in whom the cause of action is vested. This is sometimes referred to as the rule in *Foss v Harbottle* (1843) when applied to corporations, but it has a wider scope and is fundamental to any rational system of jurisprudence." (pp. 579–580)

This does not mean, however, that a member or shareholder of a company has no remedies, since there are various situations where what is known as the **"lifting of the corporate veil"** may occur, as well as **derivative claims under English law**, whereby a member may

act both to protect his own interests within the company and to protect the rights of the company itself, including the protection of minority shareholders' rights. Indeed, such cases are now recognised not only judicially, as in **E.P. Camilleri et nomine vs J.E. Mamo et nomine** (22 November 1939) and **Falla vs Sorotros**(Court of Appeal, 12 March 1976), but also by **ad hoc legislation**, namely **article 402 of Act XXV of 1995**.

However, the present action is **not** the type contemplated under the provisions of the said article, whereby a company member — including the persons specified in sub-article (5) — may bring an action and request the Court to take appropriate measures, including those specified in sub-article (3). Rather, this is an **action for damages** which the plaintiffs have brought against the defendant **in their personal capacity**.

This is clear from the facts set out in the judicial letter and the statement of claim, as well as from the plaintiffs' counsel's declaration, since the rights in question and the alleged damages and/or unjust enrichment reside **solely in the person of the plaintiff company and in no one else**. This is because the objects allegedly unlawfully appropriated by the defendant belonged to the plaintiff company, and the work agreements with third parties pertained to the company itself.

This is further confirmed by the manner in which the action has been instituted, since the plaintiffs are claiming damages for the loss **they themselves allegedly suffered**, whereas it is clear that, given that the objects belonged to the plaintiff company, any alleged damage could only have been suffered by that company. Indeed, it is admitted by the plaintiffs themselves that it was the company which suffered the alleged damages and losses.

In fact, this Court considers that the plaintiffs are fully aware of this, since the action was also instituted by the plaintiff company itself, and not only that, but was also instituted by the plaintiffs **"for every interest they may have."**

Meatland Company Limited vs Saviour Micallef is consistent with the fraud-on-the-minority exception recognised in *Tabona vs Grech* and subsequent cases, in that the Court expressly acknowledged that shareholders may, in appropriate circumstances, institute derivative proceedings to protect the company's interests. However, the Court rejected the claim on the facts because the plaintiffs sued in their personal capacity for losses suffered by the company,

rather than properly framing the action as a derivative claim. The case therefore confirms the exception in principle while strictly enforcing its procedural requirements.

2) When there has been infringement of a personal right (***Falla vs Sorotos, Cornelius sive Morris vs Eric Pace Bonello*** *(29th November 1989),* the latter of which pertained to a case where a shareholder passed a resolution in breach of the procedural rights of the company). *See also* ***Dr Kevin Dingli vs Bonnici*** *(17th February 2003)*

Dr Kevin Dingli vs Bonnici ***Court of Appeal*** **– 17 February 2003**

Ground of appeal based on the alleged lack of standing of the plaintiff

4. As he had done before the Court of First Instance, the appellant Prokidis insists that the respondent plaintiff, Kostopoulos, **could not validly institute the present proceedings in his personal capacity**, because he lacked a right of action in this regard, and that, if anything, such action should have been brought by the company directly concerned, **Glovegold Shipping Limited**.

The Court of First Instance rejected this objection based on the alleged lack of standing of the plaintiff. Instead, it agreed with the plaintiff's argument that, since **article 125(b) of Chapter 168 of the Laws of Malta** does not specify who has a right of action, it follows that **any person having the requisite interest may bring such an action**. The Court of First Instance also held that the plaintiff's interest arose from the fact that **he was also the ultimate beneficial owner of half of the company's assets**.

5. Ordinarily, a director is removed from office by a resolution of the company. There is also no doubt that a company may act to remove one of its directors on the basis of the disqualifications listed in **article 125 of Chapter 168**. The same action may also be taken by the **Registrar of Companies**, who has a duty to ensure that a person affected by such statutory disqualifications does not remain in office.

In the present case, where the company concerned is one in which **both contending parties are directors**, both individually have the **juridical representation of the company**, and both (ultimately, and if one looks beyond the "corporate veil" of two foreign companies) are **in**

practice equal owners of the Maltese company in question, an action instituted **under article 151** may also be brought by the plaintiff **in his capacity as director of the company**. The Court of First Instance reached this conclusion — which is also shared by this Court — **having regard to the particular factual circumstances of the case**. Had the plaintiff instituted this action **in the name and on behalf of the company**, the defendant — who, as seen, also has juridical representation of the company — would have had the power to **exercise his faculty to discontinue the action**, thereby bringing all proceedings to an end.

6. Furthermore, this Court considers that the plaintiff **demonstrated that he had a real, direct, and personal interest** in bringing this action. It was established to the satisfaction of the Court that the presence of the appellant as a director was **hindering the company's business**.

Indeed, when in June 1993 the respondent was in negotiations with a Greek bank to obtain credit for the company in order to purchase a vessel, the bank **abruptly terminated all negotiations** upon learning that the appellant was also a director of the company. The bank made it clear to the respondent that the appellant was a **"persona non grata"** and had been **"blacklisted"**.

It subsequently emerged that the reason for this was evident, namely the existence of **criminal judgments delivered in Greece against the appellant**. It is true that in this case the **direct prejudice was suffered by the company**, which lost the business opportunity; however, this Court has no doubt that **the shadow also fell personally on the respondent**. Accordingly, this Court considers that this ground of appeal raised by the appellant is **unjustified**, since it is clear that the respondent **had the necessary interest and locus standi** to exercise the action in question.

Dr Kevin Dingli vs Bonnici fully supports the exception allowing a personal action where there has been an infringement of a personal right. Although the company also suffered prejudice, the Court found that the plaintiff had a real, direct, and personal interest arising from his position as director and co-owner, and from the personal reputational consequences of the defendant's conduct. The case therefore falls outside the rule in *Foss v Harbottle* and

aligns with earlier authorities such as *Falla vs Sorotos* and *Cornelius sive Morris vs Eric Pace Bonello*.

3) The third exception is a general category of cases where the Court will feel that it will not be in the interests of justice NOT to allow a shareholder to bring an action.

Cecil Pace pro et noe vs Bonello pro et noe *CoA 1996*.

"A shareholder who holds a stake in a company does not have ownership over the company's assets, since these remain the property of the company in view of its separate juridical personality. Individual shareholders are not parties to judicial proceedings instituted by or against the company, and such proceedings must be brought by or against the company through the person or persons who have juridical representation of it. **This constitutes the general rule, from which there is deviation only in special instances**."

Dr Clayton Fenech, in his dissertation, *The Derivative Action under Maltese Company Law – Time to Reconsider?,* states;

"The fact that liabilities of the company are not liabilities of its members is rooted in the notion of limited liability, enshrined in Article 67 of the Companies Act which expressly states that the "member's liability is limited to the amount, if any, unpaid on the shares respectively held by each of them." Naturally, this unquestionable separation of the company's assets from that of its members is a result of the separate legal personality of companies. Inversely, rights of the company are not rights of its members and should not be enforced by the latter:

The cases we have seen so far are all cases which were filed prior to 1995. In 1995, the Companies Act was enacted, which contained 2 very important provisions, being articles 214

and 402. The first refers to the winding up on just and equitable grounds. **214 (2) (b) (iii)** reads;

214. (2) (*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 is not a totally new remedy, since this was a remedy contained in article 150 (g) of the Commercial Partnerships Ordinance. Under English Law this is referred to as the *just and equitable remedy*. This remedy results in the dissolution of the company.

Article 150(g) of the Commercial Partnership Ordinance used to provide that *"A company is dissolved .. if in the opinion of the court, there exist grounds of sufficient gravity to warrant dissolution"*.

In ***Daniel Cremona noe vs Joseph Lanfranco*** *(9th September 1975),* the Court held that the remedy under article 150(g) of the Commercial Partnerships Ordinance was similar to the remedy found in Article 222(f) of the UK Companies Act of 1948. The Court thus held that we could rely on the UK Judgements on this matter. Since then, we have always followed UK case law in the earlier interpretations of both Articles 214 and of article 402.

Article 214: The Just and Equitable Remedy

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;

Under UK Law, this action is coined **the just and equitable remedy**. This remedy has accrued a lot of case-law and academic output. It is not new to the Companies Act, since it was found also in the Commercial Partnerships Ordinance, through Article 150(g).

In ***Daniel Cremona noe vs Joseph Lanfranco et noe.***, the Court had noted that the concept of

'grounds of sufficient gravity' was probably inspired by s**ection 222(f) of the UK Companies Act 1948**. The Court stressed however that the language of what was then section 222(f) of the UK Companies Act 1948 was different from that of article 150(g) of the Commercial Partnerships Ordinance. Indeed, section 222(f) of the UK Act of 1948, now replaced by identical wording in section 122(1)(g) of the UK Insolvency Act 1986, provided that the court may wind up a company if *'the court is of the opinion that it is just and equitable that the company should be wound u*p.' Although the Court in ***Daniel Cremona noe vs Joseph Lanfranco et noe*** (conscious perhaps of the caveat laid down by the drafters of the Commercial Partnerships Ordinance) was not prepared to blindly seek guidance from English judgements and commentators on the interpretation of the remedy, it is clear that in practice Maltese courts have developed the meaning and scope of the grounds of sufficient gravity basis of dissolution in a manner broadly similar to the 'just and equitable ground in English law

The most important case under English Law when discussing the just and equitable grounds

Ibrahimi vs Westbourne Gallies *(House of Lords, 1970s)*. In this case, Ibrahimi was in a 50/50 partnership with his partner, who had a son. Ibrahimi had no children. At one point, a suggestion was raised to bring the partner's son into the partnership. They gave the son 10% each. So Ibrahimi had 40%, his partner had 40%, the son had 20%. The father and his son

immediately kicked Ibrahimi out of the partnership, since they had 60%. The argued that they were in majority, so they had a right. The House of Lords judgements, however, tells us that apart from the formality of respecting the letter of the law and the articles of association, one has to see **whether the spirit of the underlying agreement between the parties has been respected**. The just and equitable remedy, as its name implies, relies on equity. The logic behind it is that if the Court feels that an injustice has been committed, even if the letter of the law has been respected, the Court will grant a remedy. Therefore, the Courts are permitted to subject the exercise of legal rights to equitable considerations.

Avukat Dr.Mizzi v Robert Damkjaer,

2012

"Hu evidenti li l-artijiet ikkoncernati kienu ddecidew li jaghmlu partnership u tawh forma b'kumpannija. Fl-arrangement kien mistenni **li l-affarijiet tal- kumpanija jitmexxew bi spirtu ta'hbiberija u koperazzjoni ghall-beneficcju komuni ta'dawk involuti".**

In order to properly understand the context of Article 214 (2)(b)(iii), we must refer to 2 other provisions of the Companies Act, which act as subsidiary remedies;

224. (1) On the making of a winding up order, or on the dismissal of a winding up application, a copy thereof shall forthwith be forwarded by the Registrar of Courts to the Registrar for registration.

(2) Where a winding up order has been made or a provisional administrator has been appointed in accordance with the provisions of article 228, **no action or proceeding shall be proceeded with or commenced against the company or its property except by the leave of the court and subject to such terms as the court may impose**.

228. (1) The court **may by order appoint a provisional administrator at any time after the presentation of a winding up application** and before the making of a winding up order, and either the official receiver or any other competent person may be so appointed.

(2) The provisional administrator shall carry out such functions and powers in relation to the administration of the estate or business of the company as the court may specify in the order appointing him.

(3) The provisional administrator holds office until such time as the winding up order is made or the winding up application is dismissed unless before such time he resigns or he is removed by the court upon good cause being shown.

Article 224 holds that if the Court accedes to a request to wind up, that there is a degree of protection to the company, in that **third parties are not allowed to bring any actions against such company except by approval of the Court**, and subject to any conditions which the Court may impose.

Article 228 holds that a provisional administrator may be appointed upon the presentation of a winding up application, and prior to the ordering of such winding up, who shall carry out functions and powers administering the estate or business of the company.

Thus, if a company is dissolved and wound up by reason of article 214, these provisions kick in and become effective on the company.

Article 402: The Unfair Prejudice Action

The unfair prejudice action, under **article 402 of the Companies Act** allows a shareholder to file an action against any other person, including against the Company itself, against a director, or against any other person involved in that action, on the grounds that such plaintiff is being prejudiced by some affair. Under this action, it is only the **shareholder who may file the action**. If you are not a shareholder, you cannot file the action. Further, the action may only be filed in relation to the company in which the shareholder owns shares.

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.

Article 402 (3) establishes the remedies which the Court may issue in favour of the plaintiff in the case of success in his claim;

402 (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.

This article is based on the laws of **New Zealand,** as well as on Article 994 of the UK Companies Act 2006. Under article 402, the law encompasses also what is referred to as the **derivative action**. In the case ***Adonis Brace vs Braai Masters Company Ltd et*** *(FHCC, 18th March 2021),* one may find a historical background of **article 402;**

Adonis Brace v Braai Masters Company Ltd et

First Hall, Civil Court (Commercial Section), 18 March 2021

Although the wording of **Article 402(1)** was taken verbatim from a similar provision found in the **Companies Act of New Zealand**, it should be noted that New Zealand law followed the legislative development of the **United Kingdom**. In England, the provision regulating the **unfair prejudice action** in the Companies Act 1985 was **section 459**. With the enactment of the Companies Act 2006, the action came to be regulated by **section 994(1)**, in the sense

that section 459 was entirely repealed from the Companies Act 1985 and re-enacted verbatim in section 994(1) of the Companies Act 2006.

At page 485 of *Company Law* (Fourth Edition, 2016, OUP), **Brenda Hannigan** states:

*"Where the court is satisfied that a petition under s. 994 is well founded**, it may make such order as it thinks fit for giving relief in respect of matters complained o**f [s. 996(2)]."*

In order for an order to be made as provided for under sub-articles (3), (4), and (5) of **Article 402**, proof of the act complained of by the applicant is essential. This means that if, on the basis of the evidence, the court is satisfied that what is provided for in sub-article (1) has been established, the court then proceeds to grant such order as it deems appropriate in terms of the other sub-articles. If, however, the evidence is insufficient because what is required under sub-article (1) has not been established, the court must stop there and must not apply the remaining sub-articles. Therefore, proof of the legal and factual existence of what is provided for in sub-article (1) is **prejudicial** to the continuation of the action.

IV. The burden of proof

At page 1317 of *Principles of Maltese Company Law* (Volume Three, Second Edition, MUP, 2019), **Andrew Muscat** states that the burden of proof lies on the applicant to show that the act or omission complained of falls within the scope of sub-article (1). He states:

"This wording (of sub-article (1)) clearly suggests that the member need only prove one effect of the conduct, act or omission, that is, that such conduct, act or omission has been, is, or is likely to be 'oppressive', 'unfairly discriminatory', or 'unfairly prejudicial' (to a member or members), or contrary to the interests (of the members as a whole)."

It is also fair to say that having company affairs on poor governance managements usually mostly affects those in the minority shareholding which results in some serious prejudice due to their lack of power within the company - in order to marginalise the problem which these minority shareholders face - specific legislation and rules have developed in order to safeguard all rights and consequently apply sanctions to those conducting any wrongdoings.

Note that this remedy is a remedy across all reputable commonwealth jurisdictions such as NZ, Canada and naturally the UK.

Prof Muscat holds that this provision was introduced because of the fact that up to the enactment of the Companies Act, the minority shareholders were afforded protection predominately in terms of the exceptions posited by ***Foss vs Harbottle***, in terms of the exception pertaining to fraud exercised against the minority shareholders. However, even in this case, the legal position remained riddled with uncertainty and difficulty as regards to the precise scope of the remedy.

While Article 402 is a relatively long provision, attention should be shifted on 3 principal sub- articles, being 402 (1), (3), and (6).

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.

(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.

(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.

Article 402 (1) suggests that 2 alternative scenarios which warrant the filing of a 402 action, in that;

Any member of a company who complains (either)

- **the affairs of the company** have been, are being or are likely to be **or**
- **an act or omission of the company** have been 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.

While the law itself does not expressly define any of the terms *oppressive, unfairly discriminatory against, or unfairly prejudicial*, they are commonly recognised across various Common Law jurisdictions. We shall discuss this later.

Locus Standi in Article 402 Actions

(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.

Article 402 (6) defines the term *member,* which Article 402(1) qualifies as the proper plaintiff for a 402 action.

Article 127 defines the term *trustee*, referred to in 402(6) as;

"trustee" shall mean a person who may act as a trustee in accordance with the Trusts and Trustees Act and shall include any fiduciary holding shares on behalf of another person.

The question also arises as to whether a member can institute a 402 action for acts, omissions, or ways of management which prejudiced shareholders **prior** to such member became a member. **Prof Muscat** argues that if *there is conduct prior to his being registered*

as a member or otherwise acquiring locus standi, it is submitted that the plaintiff can rely on such conduct to institute an action.

On the other hand, where a member ceases to be a member, he loses all locus standi for any acts or ways of management which took place during the time in which he was a member of the company.

Moreover, the registrar may himself make an application to the court for an order under Article 402 - he can do this **where he has received a report on the company following an investigation by the inspectors** - and it appears to him that the company's affairs are being or have been conducted in manner that is or is likely to be ***oppressive, unfairly discriminate 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.***

One must note that a **majority shareholder may also bring a 402 action**, as held in ***Caroline Zammit Testaferrata Moroni Viani vs Testaferrata Moroni Viani Holdings Ltd***, in which the Court referred to the jurist **Palmer**, who held; *It is worth noting that although the section is likely to be invoked by minority shareholders, it is not in terms so restricted. Theoretically,* ***it would even be possible for the remedy to be invoked by a majority of shareholders who complain of unfair treatment by a minority - such as if the minority blocks a special resolution.***

In ***M Vella et vs Vella Bros Ltd*** *[9th March 2007]* it was emphasised that even 1 shareholder can bring an action under Article 402(6). This article has been extended even as to whether the wife or husband of a member can bring an action.

In ***Daniela Galea Souchet vs Cleland & Souchet Ltd*** *(29th September 2016)*, the court held that Daniela's share was part of the Community of assets between her and her husband - and thus allowed her to file an action although she did not appear in the memorandum as a shareholder.

On the question as to whether the plaintiff should prove whether unfair prejudice was faced in his particular regard or not, we refer to ***George Borg vs Primrose Poultry Products Ltd.***

George Borg v Primrose Poultry Products Ltd

"From an examination of Article 402(1), and supported by its study of both Maltese and English doctrine and jurisprudence, this Court cannot agree with the wide interpretation being given by the applicant to the first limb of Article 402. The Court states that the correct interpretation is that proof of oppressive, discriminatory, or unfairly prejudicial conduct is essential in order for the Court to grant relief, in the sense that such conduct need not necessarily be shown to have been, or to be likely to be, oppressive, discriminatory, or unfairly prejudicial towards the applicant per se. ***The provision is also satisfied if the act or omission is oppressive, discriminatory, or unfairly prejudicial towards other particular members of the company or towards the interests of the members of the company in general****."* (*Vella Joseph et al v Vella Bros Ltd*, Court of Appeal, 9 March 2007)

The Court went on to comment on the **raison d'être** of the provision:

"Article 402 of the Companies Act grants fairly wide discretion to the courts, since these provisions are intended to safeguard and protect the shareholders of commercial companies, particularly minority shareholders who are therefore unable to regulate the manner in which the company in which they have an interest is managed. As rightly submitted, the appellants' arguments find no support either in the wording or in the spirit of the law, which has placed no limits on the situations falling within the parameters of Article 402 of the Act, nor on the claims and remedies which may be granted. ***This is because this provision, which is based on section 459 of the English Companies Act 1985, is inspired by principles of equity rather than by strictly legalistic rights, so as to enable a remedy to be granted."***

[The Court here affirmed that Article 402 is based more on the concept of equity than on the concept of strict legal rights.]

What must the plaintiff prove?

*"What is necessary is that the shareholder proves that, as a result of the particular management of the company**, he is suffering, or may also suffer, prejudice of an oppressive, unjust, or discriminatory nature."***

Such management may refer simply to a **specific act** or to an **omission** on the part of the company.

The prejudice may relate to:

- the shareholder bringing the proceedings,
- another shareholder, or
- the **general interests of the shareholders as a whole**.

There is **no requirement** for the plaintiff to prove that he will certainly suffer prejudice in the future. Such proof may be established on a **reasonable basis of possibility** (*Vincent Monreal et v Lino Delia noe*, decided by the First Hall of the Civil Court on **13 May 1999**).

In fact, the English courts decided in the case of **Re Bovey Hotel Ventures Ltd** that:

"The Court will not give a list of situations when this remedy may be resorted to; however, one principle remains clear. A shareholder may make use of this article when his shareholding in the company has been seriously diminished, or at least seriously jeopardised, by reason of a course of conduct on the part of those who have the de facto control of the company, which has been unfair to the member concerned."

In **Palmer's Company Law**, it is stated that this part of the law:

"appears to give the shareholder a procedurally easy way of complaining about 'unfair' action on the part of the controllers of his company."

It is nevertheless important that **prejudice must be proven**.

Further, ***Pennington*** holds that the petitioner must "*prove his allegations and they constitute an unfair prejudice of the **petitioner himself** or of the **petitioner and all or some of the other members in the company***

Derivative Actions as not forming part of our law

The last point to address vis-a-vis the locus standi of the plaintiff pertains to the notion of **second- tier shareholding**. For instance, if one is a minority shareholder in Company A, which holds shares in Company B, then the question arises as to whether such minority shareholder has the standing to file an action on unfair prejudice on Company A exercised by Company B. In ***Suzanne Busuttil vs Francis Busuttil and Sons Ltd,*** the Court confirmed that since the minority shareholder in A does not have direct shares in B, then the shareholder cannot institute a 402 action against Company B. Company A reserves this right as a separate legal personality, but the shareholders of Company A cannot in themselves file the action.

The remedy which second tier shareholders attempted to resort to in this regard pertains to what is referred to and accepted under UK Law as the *derivative action* in terms of **article 402 (3)(e)**, which holds;

> **402 (3)** (*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

Prof Muscat makes reference to ***Gordon Mizzi et vs Dr John C Grech et*** *(FHCC, 14th February 2005)*, in which the Court held that an **indirect shareholding is not sufficient to file an action under article 402** directly. In order to bypass this restriction, however, second tier shareholders sought to invoke an action under **article 402(3)(e)** to request the Court to direct Company A to institute an article 402 action against Company B. In practice, however, it appears that these requests tend to be rejected, as has been decided by **Judge Zammit McKeon** on a number of occasions. **Judge Spiteri Bailey's** stance on the issue has yet to be determined.

L-Arkitett Raymond Vassallo et v Anthony Trigona Parlato et

Court of Appeal, 30 September 2016 – Case No. 716/11 AF

With regard to the first objection raised by the Carbonaro spouses and the second objection raised by the Parlato Trigona spouses, insofar as they are connected and concern the **admissibility or otherwise of the derivative action in Maltese law**, the Court of First Instance dealt with them together and, after considering local jurisprudence on the matter, observed that it could not be ignored that (in the particular circumstances of the case, where the appellant Vassallo is a shareholder in the company **Parade Limited**, which in turn is a shareholder in the company **Windsor Holdings Limited**, and where the proceedings concern the latter company), this Court in case number **842/09** had held that, **qua shareholder of Parade Limited**, the appellant could not institute proceedings in terms of **Article 402 of Chapter 386**, since **Maltese law does not allow a 'second-tier' shareholder** to do so.

The Court of First Instance then referred to the observations made by the First Hall of the Civil Court in the case **Migdal v Mizzi**, decided on **18 May 2001**, where it was stated:

"Above all, this Court, in the discharge of its duty to ensure that the laws are observed, must always have the power to do what is necessary so that no one is allowed to benefit unjustly from his own bad faith: this is what the principle ***fraus omnia corrumpit*** *means."*

16. In this part of the appealed judgment lies the reasoning that led the Court of First Instance to depart from the terms of the aforementioned article. This is a matter which will be addressed in the second ground of appeal; however, with regard to the conclusion reached by the Court of First Instance, this Court does not find that it lacks reasoning, although, as will be seen later on, this Court does not agree with that conclusion.

The First Hall of the Civil Court declared that the derivative action is **not part of Maltese**

Company Law since the legislator, in drafting the Companies Act (which is based principally on the United Kingdom Companies Act) opted to disregard the derivative action, instead widening the grounds of article 402 of Cap 386. Notwithstanding, the provisions of the Companies Act, the First Hall of the Civil Court held that in the scenario where misconduct and conflict of interest were being alleged and due to the particular circumstances of the case then plaintiffs could not institute proceedings under section 402 of the Companies

Act because such an action cannot be instituted by a "second-tier shareholder" i.e. a shareholder of a company holding shares in the company in which the wrongdoing is alleged.

The Remedies Available for Successful 402 Actions

Article 402(3) provides for the remedies which the Court may grant in the case of a successfully instituted 402 action.

> (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
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> (*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.

Prof Muscat ascertains **2 different scenarios** in which a remedy under Article 402 (3) will be granted, being;

1) If the affairs of the company have been or are being or are likely to be conducted in a manner that is, or is 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 and/or;

2) If any act or omission of the company has been or is likely to be, oppressive to, unfairly discriminatory against, or unfairly prejudicial to, a member or members or to the interests of the members as a whole.

In relation to the first scenario, the Plaintiff must show that the conduct complained of relates to the **manner in which the company's affairs have been, are being, or are likely to be conducted** in an oppressive manner. It is pivotal to understand what constitutes a *manner in which affairs are being managed* prior to proving whether such affairs are being oppressively managed.

Prof Muscat clarifies;

"However, a person appointed by a holding company on the board of a subsidiary should not be regarded as acting in the affairs of the holding company when voting at meetings of the subsidiary. Moreover, a shareholder who settles a company's bank loan and takes over the bank's security without informing the other shareholders, should be regarded as having acted in ***his personal capacity and not as conducting the affairs of the company.*** *The same approach should apply where a controlling shareholder enters into negotiations to buy a minority's shareholding. Where, however a director* ***uses his dominant in the company to neutralise the institution of proceedings against him, that use of dominant position would constitute conduct of the company."***

Furthermore, the Plaintiff need not prove that the damage or oppressive acts have already taken place. It suffices for the plaintiff to prove that the management of the affairs **is likely to** be unfairly prejudicial.

With regards to the second scenario, the law refers to ***any act or omission of the Company***.

According to **Profs. Muscat,** *"To bring himself within the second scenario, the member must prove an "act or omission of the company" which has been, is or, is likely to be* ***oppressive to, 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.*** *Where the act or omission is that of the board (as is usually the case) then the act or omission would undoubtedly be that of the company. Similarly, the acts or omissions of a managing director to whom broad powers have been delegated by the board and the acts or omissions of an executive director who has been allowed to conduct the affairs of the company without interreference from the other directors should also be considered as acts or omission of the company. On the other hand, a director who steals cash from the company's safe would be acting in his personal capacity and would not involve the company on any corporate*

act.

Should acts or omission of the shareholders be treated as those of the company? Although the

matter is not free from controversy, there should be no reason, in principle, why the acts of the shareholders should not, in appropriate circumstances be regarded as those of the company. Thus, a resolution passed by the members in general meeting will almost certainly constitute a corporate act. ***Prentice*** *has convincingly argued that although the decisions of shareholders may not necessarily be regarded as those of the company so as to affect the company's relationship with a third party, they will be binding on the shareholders inter se and affect their interests and this consideration should bring the decisions within the parameters of the unfair prejudice remedy. He has also argued that not only should formal acts of the shareholders be treated as those of the company, but so should informal acts which are accorded a similar constitutional status to formal acts."*

*"Similarly, the same wording makes it clear that proceedings can be instituted in respect of an act or omission which is taking place at the time of the institution of the proceedings, or which is likely to take place sometime thereafter. In contrast, with the first scenario, however, the wording of the second scenario seems to suggest that the second scenario contemplates an act or omission which would have already occurred at the time of the institution of the action and that the words "**have been or are or are likely to be**" being intended to refer to the **effects** of such act or omission (namely their effect as oppressive, unfairly prejudicial or discriminatory) so that although the act or omission complained of would have already occurred before the action is instituted, it is sufficient to show that the act or omission is likely to have or will have the negative effects prescribed in article 402 at some time in the future, after the institution of such action.*

*Admittedly the wording of article 402 (1) is **not very clear on this point and may be open to different interpretation**s. Indeed, article 402 (3b), which lists amongst the remedies which may be given by the court the restriction or prohibition of the carrying out of any proposed act, appears to support the view that proceedings **can be filed in respect of the proposed future acts**. Arguably, however, article 402 (3b) deals with remedies, and the act which the court may restrict or prohibit as a remedy thereunder may not necessarily be the same act complained of (which would have led to the institution of the action.) A clarification in the law to settle this point in a definitive manner would be welcome**. In the meantime if one were to adhere to the interpretation that the article 402 remedy is available in respect of proposed future acts of the company, it is submitted that before a proposed act justifies relief it should have reached a degree of maturity, such that there is likelihood and not merely potentiality that it will be implemented,** although it should not be necessary that there be an immediate threat that the proposed act will be carried out."*

Note - while under article 214, the Court may appoint a director to administer the affairs during the winding up, under 402 this is not possible. Further, article 402 is invoked by a simple application, and **not a sworn application**. More controversially, there is a series of judgements that hold that there is no right of appeal to a 402 action. In ***Shaw vs Shaw***, the

Court held that you could not file an appeal to an article 402 action, reasoned because under article 401, the law contains a right of appeal. The legislator intentionally excluded the right of appeal from article 402 (ubi lex voluit dicuit).

Oppressive, Unfairly Discriminatory Against, or Unfairly Prejudicial

Once one of the above mentioned 2 scenarios has been identified, the plaintiff must then prove that the management, act, or omission in question is tantamount to oppressive, discriminatory, or prejudicial behaviour. These terms are not defined by law but are utilised in other common law jurisdictions. ***Pennington*** holds that unfairly prejudicial conduct included **fraudulent or oppressive conduct by majority shareholders** and **breaches of fiduciary duty by controlling directors** which would entitle a minority shareholder to bring an action against them.

The **degree of proof** required in this regard is that of a **reasonable basis of probability**. In ***Joseph Vella vs Vella Brothers Limited,*** the Court held:

*"Ma hemmx ghalfej li r-rikorrent jipprova li huwa zgur se jsoffri xi prejudizju fil-futur**. tali prova tista ssir fuq bazi ragjonevoli ta' probabilta**."*

It should be noted that it is not necessary for the member to show actual irregularity, an invasion of his legal rights, a lack of probity to a want of good faith by those in control of the company. Indeed, if courts were to require some independent irregularity or unlawfulness as a condition for granting relief under the unfair prejudice remedy**, then the remedy would be reduced to a mere procedural substitute for the protection granted under general principles of law and would fail to cover a range of conduct which would be clearly**

“unfairly prejudicial”, but which would not be illegal in the sense of some independent legal impropriety.