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Lecture 4

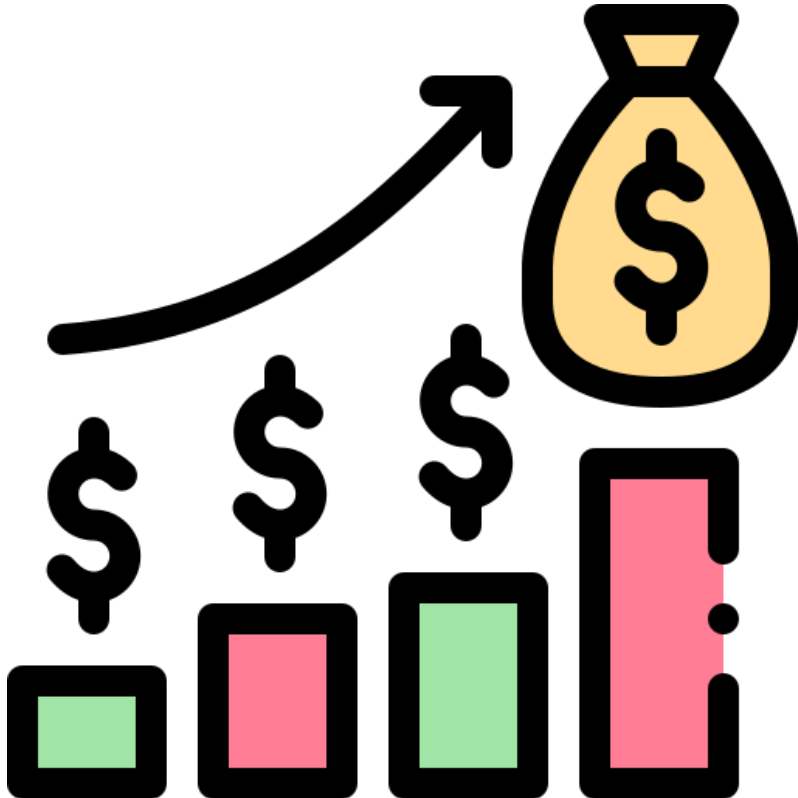
Capital

Share Capital vs Debt Capital and Classes of Shares

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ADVOCATES

Introduction



A distinction must be drawn between 'share capital' and 'loan capital'.

Share capital broadly refers to the funds contributed to the company's resources by the shareholders, qua shareholders, and it also represents rights in the company.

On the other hand, **loan capital** refers to the funds borrowed by the company. In contrast to share capital, loan capital represents rights against the company.

Loan Capital

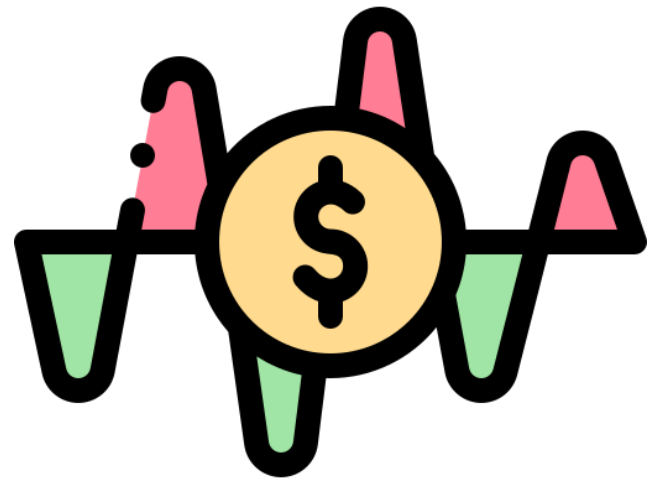
Debentures are a form of loan capital a company can use to raise finance; and debentures may be issued in a number of ways:

- 1. Single debentures**
- 2. Debentures issued in series**
- 3. Debenture stock**

Debentures may be either redeemable or irredeemable.

Share Capital

1. Authorised capital/nominal capital
2. Issued capital
3. Paid up capital
4. Called-up capital
5. Uncalled capital



Authorised capital/nominal capital

This is defined as the total of the nominal value of the shares which a company may issue. The authorised capital is the figure which appears in the capital clause of the company's MoA.

Issued capital

This is the total of the nominal value of the shares which are allotted to the shareholders. It is that part of the authorised capital which is actually issued and taken up by the shareholders.

Paid up capital

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

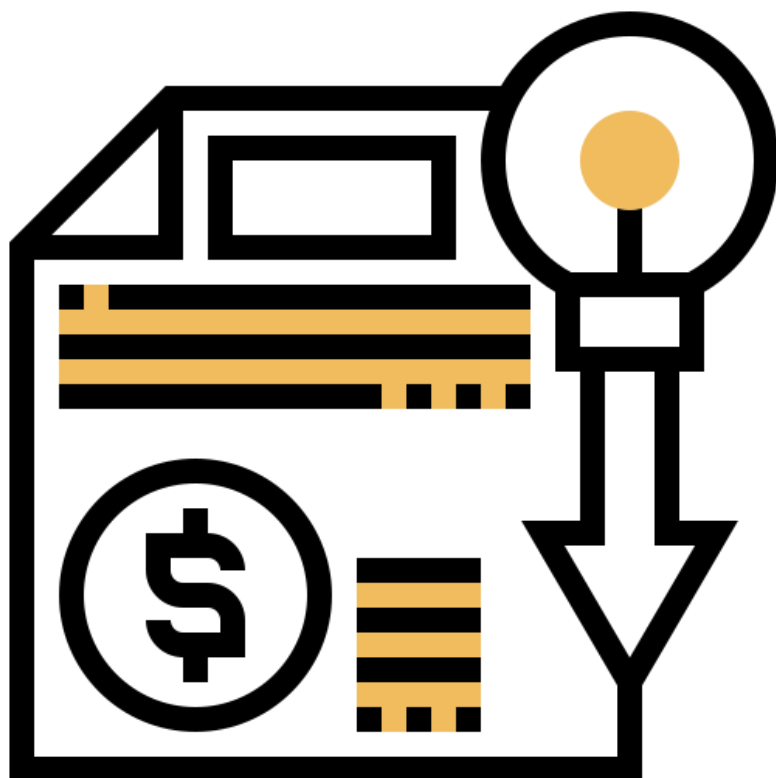
Called up capital

This is not defined in the CA, however, it essentially refers to the total amount of issued capital which the shareholders are called to pay.

Uncalled up capital

This is not defined in the CA, however, it presumably means that part of the issued share capital which is not called-up capital

Minimum capital amounts



Private company → €1,164.69 (Lm500)

Public company → €46,587.47 (Lm20,000)

In the case of a **private company**, not less than **20%** of the nominal value of each share taken up must be paid up on the signing of the memorandum.

In the case of a **public company**, the minimum value to be paid up on the signing of the memorandum is **25%**.

Classes of Shares

The share capital of a company must, as a general rule, be divided into shares of a fixed amount. The fixed amount is the nominal or par value of the shares. The determination of such value is left to the discretion of the subscribers.

1. Ordinary shares
2. Preference shares
3. Deferred shares
4. Convertible shares



Ordinary shares

Every company is required to have ordinary shares. Thus, when a company only has one class of shares, these will be regarded as 'ordinary shares' or simply as 'shares'. These shares will have the same nominal value and the same rights.

Two other advantages that ordinary shareholder possess are:

- _ All or most of the voting power at the general meetings is vested in them, and it is they who can ultimately control the company.
- _ Entitled to take up, pro rata to their existing shareholding, any further ordinary shares which may be issued.

Preference shares

Preference shares are those shares entitled to preference over ordinary shares, in respect of dividends and repayment of capital on winding up. However, this preferential treatment does not necessarily mean that a preference shareholder will always receive the payments due to him. Preference and ordinary shares form part of the company's share capital, and the amount paid on the shares does not qualify as a loan. Accordingly, dividends may only be paid out if the company has made sufficient profit. A payment of a dividend which exceeds the available profits would constitute an unlawful return of capital.

Deferred shares

These shares may have multiple voting rights compared with ordinary shares, and are sometimes referred to as founders' shares. This is because founders or promoters are sometimes issued these shares in consideration for the services rendered. **It must be stated however that founders' shares need not necessarily be deferred shares.**

Convertible shares

These shares are corporate fixed-income securities that the investor can choose to turn into a certain number of shares of the company's common stock after a predetermined time span or on a specific date. The fixed-income component offers a steady income stream and some protection of the invested capital. However, the option to convert these securities into stock gives the investor the opportunity to gain from a rise in the share price.

Increase in Share Capital



An increase is to be decided upon by an **ordinary resolution of the company** (unless the M&As require a higher percentage than that normally required for an ordinary resolution).

The M&As or an extraordinary resolution may however permit other percentages.

Offering shares on a pre-emptive basis

Wherever shares of a public company are proposed to be allotted for consideration in cash, those shares are to be offered on a pre-emptive basis to shareholders in proportion to the share capital held by them.

The right of pre-emption may, however, in respect of particular allotments, be restricted or withdrawn by extraordinary resolution of the general meeting.



Return of Allotments

Whenever a company makes any allotment of shares, it is obliged, within **one month thereafter**, to deliver to the Registrar for registration, a return of allotments (Form H).

Acquisition by company of its own shares

In order for a company to acquire its own shares, a number of conditions generally need to be satisfied.

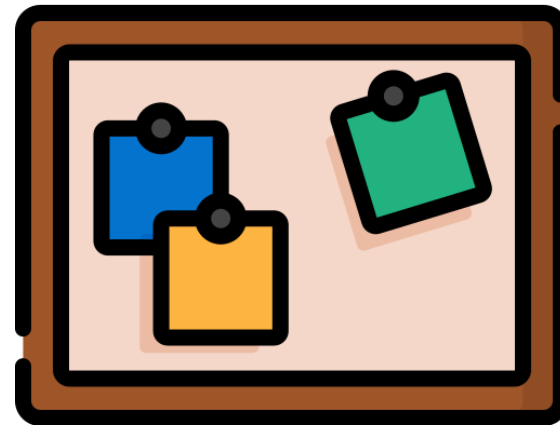
Redemption of preference shares

Whenever preference share are redeemed, the company should deliver to the Registrar for registration (**Form T(1)**) within **14 days after the date of redemption**.



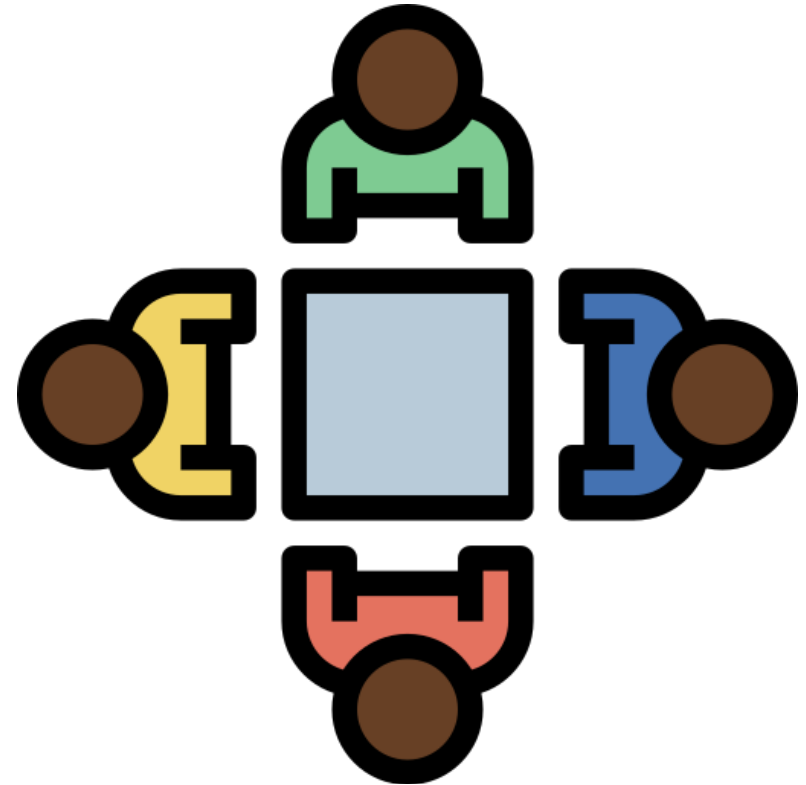
Delivery of notice of transfer or transmission of shares

In the case of a transfer or transmission *causa mortis* of shares, the company is obliged, **within 14 days after the date on which a transfer of any such shares is registered with the company**, and **within one month from the date on which any such shares transmitted *causa mortis* have been registered in the name of the person entitled to be registered as the holder thereof**, to **deliver to the Registrar for registration**, a notice of the transfer or transmission – stating the names and addresses of the transferees or the name and addresses of the person entitled to the shares transmitted *causa mortis* as the case may be.



Class Rights

When preferential or other special rights are attached to a class of shares, it is important to ascertain whether and in accordance with which procedure these rights can be varied. An important rule is that no change or variation to class rights may be effected unless the M&As authorise such change or variation.



Majority Rule and Minority Rights

MAJORITY RULE

This is an established principle of company law whereby the majority of the shareholders hold the decision making power of the company. Sometimes this dominant position leads to an oppression of the minority shareholders from the decision making processes.

MINORITY RIGHTS

The CA provides for the protection of minority rights and the claims which may be raised by a minority shareholder in order to protect his rights.

A fundamental remedy which was introduced in Malta by the CA protects members against affairs of the company which have been, are likely to be conducted in a manner that is, or that any act or omission have or are likely to be oppressive, unfairly discriminatory and unfairly prejudicial.

Unfair prejudice

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



The plaintiff claiming unfair prejudice

Only a **member** of the company or the Registrar can make an application to the court for relief under article 402.

Member → shareholder of the company
→ Entered into the register of members

Art.402, however, does **not** cater for the situation where shares have been transferred or transmitted by operation of law other than by testate or intestate succession.



Gaetano Bonnici et vs Age Concern Company Limited



Facts:

- The plaintiffs filed an action against the defendant company for the latter's failure to distribute dividends. **The case was not instituted under art. 402.**
- 6 days after instituting the action, the plaintiffs transferred their shares to the other shareholders (as part of a previously agreed arrangement).
- The defendant company raised the plea of lack of juridical interest of the plaintiffs.

Decision:

- The Court rejected the defendant's plea and held that the plaintiffs did have a *locus standi*. The defendants also pleaded that the plaintiffs' actions could have not been upheld, as the only remedy they had was an art.402 action which they failed to exercise.

Caroline Zammit Terstaferrata Moroni Viani et vs Testaferrata Moroni Viani (Holdings) Limited



Facts:

- The company's M&As established that all directors were to serve office until the next AGM during which an election of directors would be held. An election of directors required 75% of the votes.
- There were two groups of shareholders: one holding 60% of the issued share capital, and the other holding 40%. The two groups could **not agree on the composition of the board and a stalemate was reached**. The majority shareholders commenced an action under art. 402.

Decision:

- The court held that the provisions of art. 402 were designed to safeguard and protect the shareholders of the company, independently of whether they were minority or majority shareholders.
- It added that it was entitled to give an appropriate order where the affairs of the company were being conducted in a manner that was prejudicial to interest of the company or of its members.
- The court proceeded to appoint a board of directors composed of an independent chairman together with 2 directors representing each of the two sides of the dispute.

Jean Karl Soler et vs Raymond Vassallo pro et noe (Court of Appeal, 2012)



Facts:

- One of the plaintiffs (JS) was a direct shareholder in defendant company JM Vassallo Vibro Blocks Ltd (JM Blocks), while the other plaintiff was JKS who had been declared as having no *locus standi* in the previous proceedings.
- Another defendant company was JM Vassallo Vibro Steel Limited (JM Steel), a wholly owned subsidiary of JM Blocks.
- None of the plaintiffs held any shares in JM Steel.
- The action filed by the plaintiffs was essentially an art.402 action. JM Steel pleaded that it should be non-suited as none of the plaintiffs held any shares in it.

Jean Karl Soler et vs Raymond Vassallo pro et noe (Court of Appeal,2012)



Decision:

- The Court of Appeal was of the view that the term “affairs of the company” in art.402(1) needed to be interpreted in the light of common law judgements on the matter.
- The Court observed that common law judgements held that an enquiry into the “company’s affairs” could extend to an enquiry into subsidiary companies, particularly where there are common directors.
- The Court therefore concluded that the conduct of the common director in JM Steel may affect the interest of the plaintiff JS and she therefore had a right to have the activity in JM Steel also examined. Accordingly, both JM Block and JM Steel have a juridical interest to be parties to the suit, even to enable them to defend their interests.

Ronald Azzopardi vs Taormina Holdings Ltd and Sovereign Hotels Ltd



Facts:

- The Plaintiff was a director and minority shareholder of Sovereign Hotels Ltd. (Taormina was majority shareholder). In the financial years of 2001, 2002 and 2003 the company had four directors. The draft accounts had been prepared by one director and were sent to the auditors but were not yet approved by the board.
- After several years, the plaintiff (now the sole director) collected the draft audited accounts from the auditors, and under pressure to conclude the accounts, he convened an AGM to approve the accounts. The accounts had not been signed by the directors nor approved by the board.
- Since none of the four directors appeared for the meeting, the meeting was adjourned and held by one shareholder. The plaintiff approved the accounts himself. The accounts were refused by the auditors since they the former directors refused to sign back-dated accounts. The plaintiff was incurring fines and felt that he was placed in a position where it was impossible for the accounts to be signed by two directors; and therefore proceeded to file an unfair prejudice action.
- The plaintiff sought for it to be declared that Taormina Holdings Ltd acted against the interests of the company and its members, and that the failure of the company to file the audited accounts for the years 2001-2003 was harmful to the company, its directors and its members.

Ronald Azzopardi vs Taormina Holdings Ltd and Sovereign Hotels Ltd



Decision:

- The Court made reference to the Companies Act and observed that the directors had a duty to ensure that accounts are drawn up clearly and in accordance with the provisions of the Act. The court maintained that plaintiff should have first insisted that the accounts were approved by the board and were duly signed before they went to the auditors.
- The Court also said that the plaintiff had no right to insist that the persons who today no longer served as directors of the company should sign these accounts back-dated to the time when they were directors – this was not the way a company should be administered.
- The court also said that the auditors should not have accepted the accounts unless they were first approved by the board and signed by the directors.
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- It was held that it was true that article 402 conferred upon the court wide powers to dispense an equitable remedy. However, the Act also contained detailed provisions on several issues – the breach of which triggered penalties.
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- The Court was of the opinion that it should not intervene in the absence of any ‘unfair prejudice’, ‘oppression’ or ‘discriminatory act’ as contemplated by article 402, and suggested that the shareholders of the company may wish to consider winding up the company because it was obvious that they had lost trust in each other.

The defendant in an action under art.402

The Companies Act does not specify the person or persons against whom an action under art.402 is to be brought.

The reason is that the **choice of defendant or defendants depends on the facts of the case and on the type of relief sought.**



Next week:

→ Continuation of capital: capital maintenance and pledging of share capital





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