

# DIRECTORS LAW AND COMPLIANCE CERTIFICATE SESSION I

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# INTRODUCTION

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The **business of a company** is managed by the **directors**. The directors are expected to act collectively as a board, although the memorandum or articles of association may also provide for delegation of extensive powers to smaller committees or even to individual directors.



# Article 136A of the CA

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*“a director of a company shall be bound to act honestly and in good faith in the best interests of the company.”*

In addition, 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.

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The Code of Principles of Good Corporate Governance provides that the board has the first level of responsibility of executing four basic roles of corporate governance:



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The term “**director**” is not defined in the CA - simply provides that “**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 director of the company as those carried out by a director”.*

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Almost invariably, directors are **individuals** (physical persons). The CA however recognises the notion of a “**corporate director**” and occasionally companies do have bodies corporate as directors. A “**body corporate**” is defined as an entity having a legal personality distinct from that of its members, and includes a foreign corporation.

*A company whose securities are listed on the Malta Stock Exchange may however, only have individuals as directors.*

# Different Types of Directors

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Directors

Executive  
Directors

Non-  
Executive  
Directors

*De facto*  
directors

Shadow  
Directors

Alternate  
Directors

# Executive vs Non-Executive Directors

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## Executive Directors

- Concerned with actual day-to-day management
- Have executive functions in addition to board duties that would be delegated to them by the Board or Articles of Association

## Non-Executive Directors

- Outside directors
- More of an advisory/supervisory role to protect the company's interests
- Must be independent and impartial

**RESPONSIBILITIES AND DUTIES AT LAW ARE IDENTICAL**



# *De facto* Directors and Shadow Directors

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## *De facto* Directors

- Person may **not** have been **formally appointed** as director
- person carries out **substantially the same functions** in relation to the direction of the company as those normally carried out by a director.

## Shadow Directors

- People who are not directors but occupy some **position of influence** in a company (e.g. a majority shareholder)
- In the **habit of giving directions** to the directors of the company

# *Alternate Directors*

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- Appointed by a director
- Usually entitled to perform all functions of his appointed as a director in his absence
- M&As of the company must explicitly provide for possibility to appoint alternate directors.

# Appointment

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- Appointment by Shareholders
- Appointment by casual vacancy
- Appointment by third parties

# POWERS OF DIRECTORS

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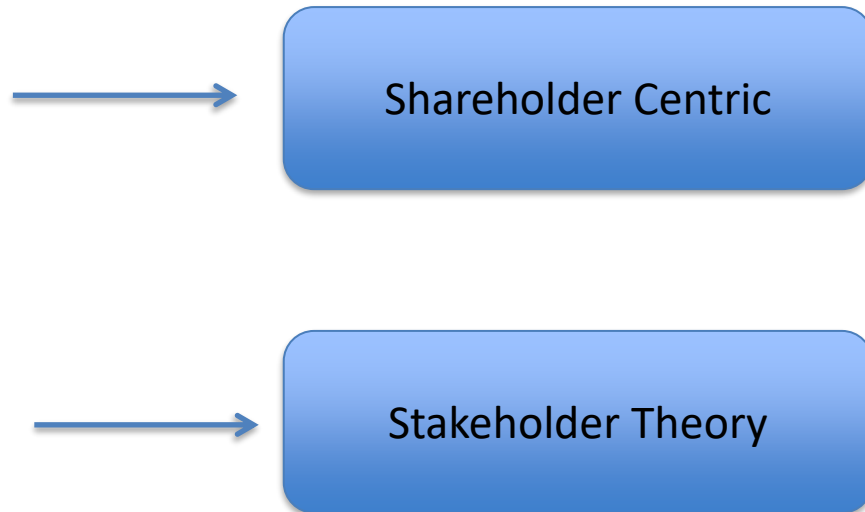
- It is common for directors to be granted broad discretionary powers.
- Arguments in favour: efficiency/smooth managements;
- Risks: Abuse of power

# LIMITS ON DIRECTORS' POWERS

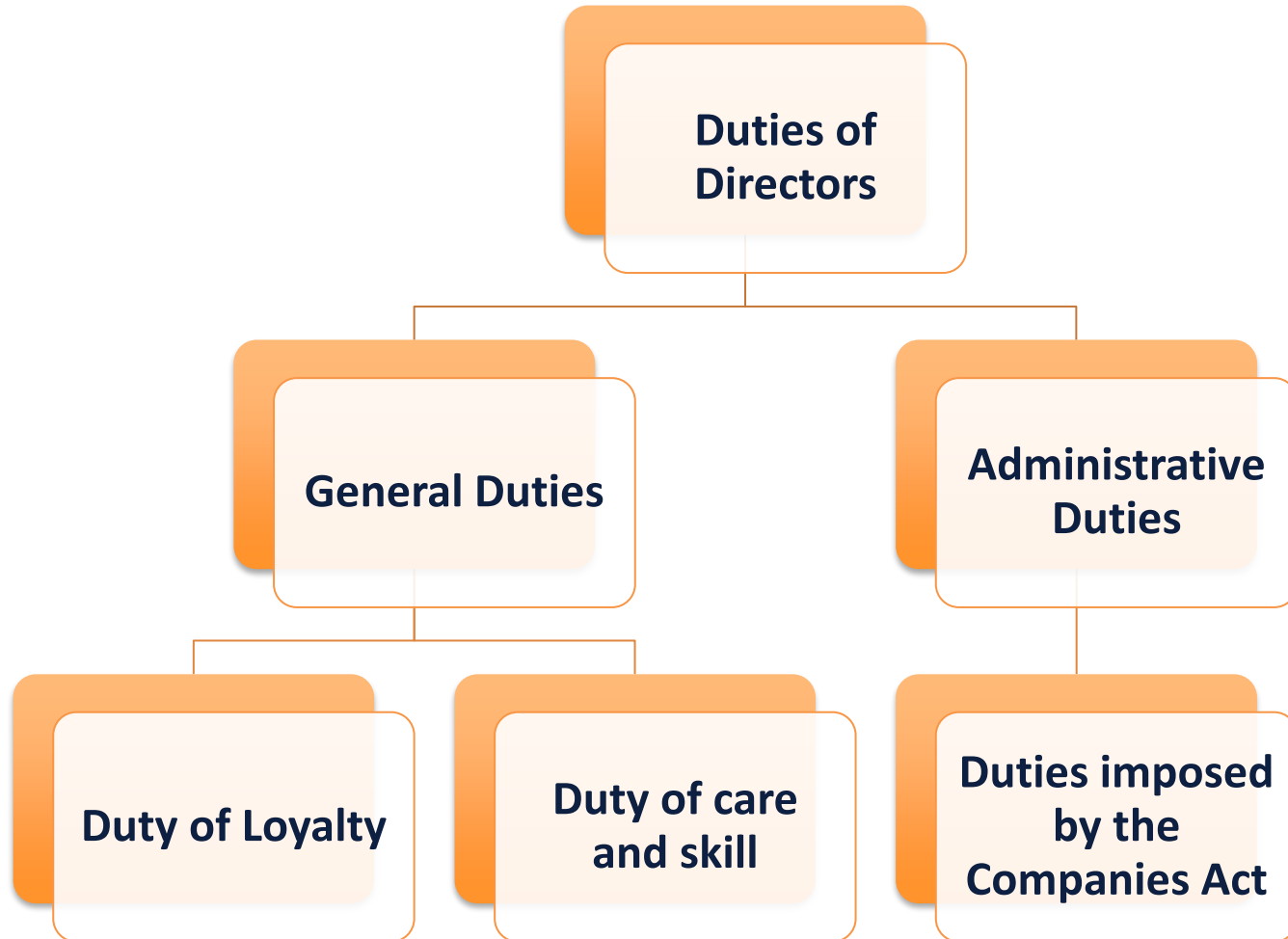
- Limits are those imposed in the M&As or anything contained in the law which requires a shareholders' resolution at a general meeting.
- Another restraint on potential abuse is the set of duties which company law imposes on directors.
- However anything done by a director which is beyond his powers, shall be binding on the company unless that act exceeds the limits of their authority by virtue of the CA.
- Any limitation on the powers of the directors cannot be relied on as against third party even if it arises from the company's M&As.

# FOR WHOSE BENEFIT IS A COMPANY RUN?

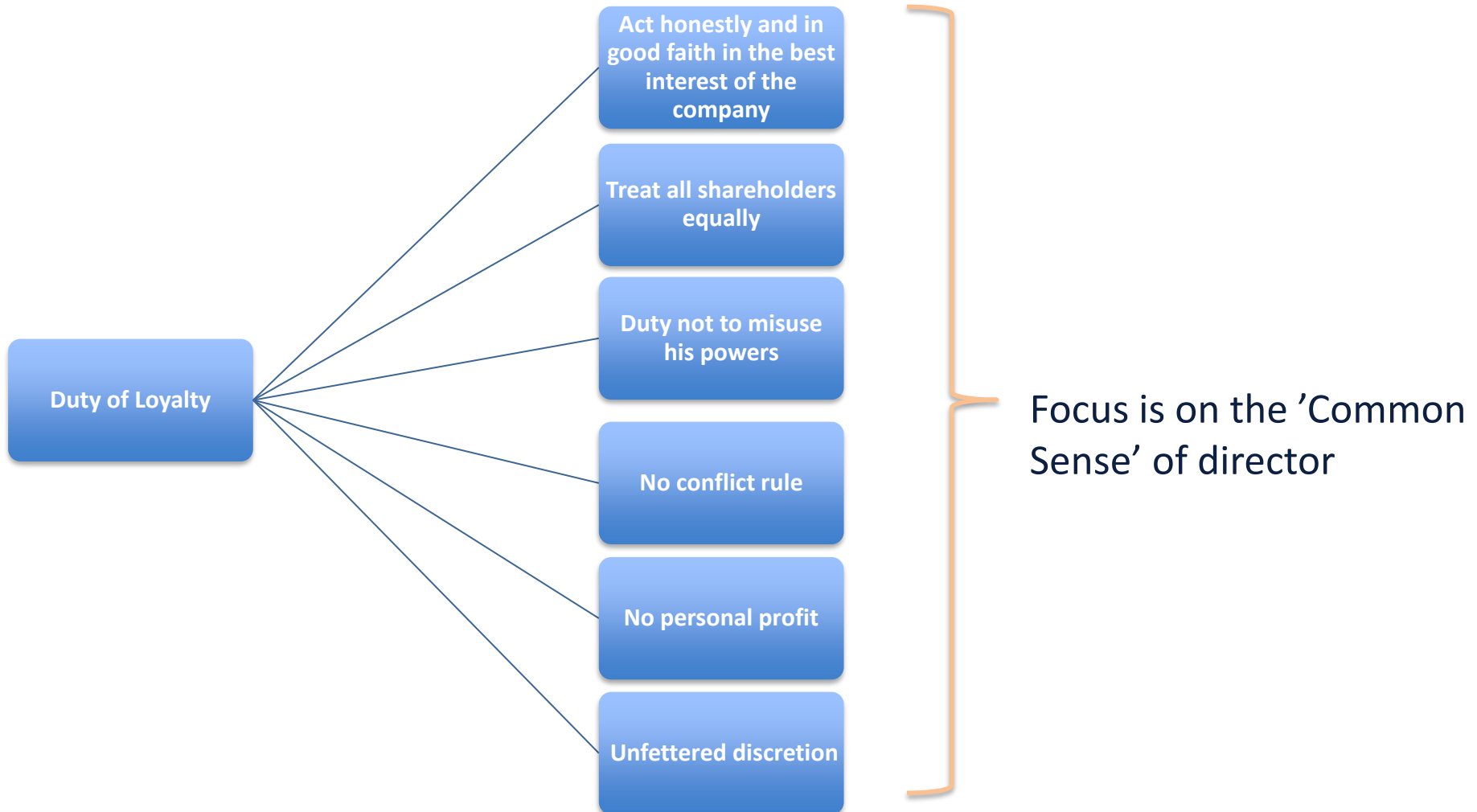
Various theories have been proposed as to how a company should be run and ultimately to whom directors owe their duties:



# DIFFERENT TYPES OF DUTIES



# DUTY OF LOYALTY





## A. The duty to act honestly and in good faith in the best interests of the company.

- Found in Art.136A(1) of the Companies Act
- Compliance with the rule is tested in ‘common sense’ principles

## Re. Smith & Fawcett Ltd

- \_ Directors are required to act bona fide in what they consider, and not what a court may consider, is in the best interests of the company

## Re. W & M Roith Ltd

- \_ There need not be actual dishonesty for there to be a breach of duty. It is sufficient that the board did not direct their minds to the questions as to whether the proposed transaction is in the interests of the company

## B. Equal treatment of all shareholders

### Scottish Cooperative Wholesale Society Limited v. Meyer

Nominee directors owe their duties to the company as a whole and not the shareholder which appointed it.

### Mutual Life Insurance Co of New York vs. Rank Organisation Limited

Court considered that the decision of the directors not to issue shares in favour of all the ordinary shareholders (excluding Canadian and American shareholders) was not to have been in breach of the equality of treatment principle in view of the onerous requirements which the Securities and Exchange Commission and the equivalent Canadian commission imposes.

## C. Proper use of powers/ Improper Purposes

- Duty to remain within their powers.
- Directors must not do any act or enter any transaction which is illegal or ultra vires or beyond the powers conferred to them.
- Directors cannot exercise any powers for a purpose other than that for which they were conferred. Even if the directors act honestly for what they believed to be in the interest of the company, they may still be liable for breach of duty if they exercise their powers for a different purpose than that for which they were conferred.

## Third party reliance (Article 137)

- 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 BoD which exceeds the limit of its authority or by any director which is beyond his powers is binding on the company unless that act exceeds the powers granted to BoD or to a director, as the case may be, by virtue of the Companies Act (A. 137 (4)).
- Any limitation on the powers of the BoD or of any director of the company cannot 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 (A. 137(5)).

## Third party reliance (Article 137)

- \_ Where an act of the company falls outside the company's object the company is not 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 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. (A.137(6)) .

## Howard Smith Ltd v. Ampol Petroleum Ltd

- The directors had the power to issue shares in W Millers;
- W Millers was subject to a hostile takeover bid by a large petrol company called Ampol. Ampol already controlled 55% of the shares in the company;
- Another company, Howard Smith, however, had offered to better the terms of employment of the directors in the future and for this reason, the directors did not want Ampol to complete the takeover bid;
- The directors issued new shares to Howard Smith with the effect that Ampol was not in a position to takeover the company.

The court decided *that it was not improper for the directors to issue shares to a large company to secure the financial stability of the company, however if the purpose was solely to dilute the majority voting power to obtain some personal advantage, then the issue of shares would be improper and not in the best interests of the company.*

## D. Duty to avoid conflicts of interest

- Positive duty on directors to ensure that their personal interests do not conflict with the interests of the company.
- A director having a continuing material interest that conflicts with the interests of the company should take effective steps to eliminate the grounds for conflict.
- Conflict of interests can be managed (A. 145 of the CA).



## E. Prohibition of loans, guarantees to directors

- Art.144(.1)(a) of the CA provides this prohibition. However there are carve outs to this general rule.
- Consequences of such a breach is that the unlawfulness of the contract will make such contract null ab initio.

## F. No profit rule

- Prohibits directors from: (a) making secret or personal profits from their position without the consent of the company; (b) making personal gain from confidential information; and (c) using any property, information or opportunity for their own or anyone else's benefit.

## MISUSE OF INFORMATION / CORPORATE OPPORTUNITY

### Industrial Development Consultants v. Cooley

Cooley was employed with IDC and was involved in negotiations with the Eastern Gas Board to secure construction contracts for IDC. It was clear that EGB were no longer interested in contracting with IDC. The board of EGB approached Cooley to take on a position with EGB. Cooley resigned and joined EGB on the premise that he was sick. IDC accepted the resignation.

The court held that Cooley occupied a fiduciary position which subjected him to an obligation to avoid possible conflicts of interest between his personal interests and his fiduciary duties. Although he knew that EGB was embarking on a new project but not willing to contract with IDC, he used that information for personal gain. The court found him liable on the grounds of misuse of information.

## G. Duty not to compete with the company

- A director may not carry out business which is in competition with that of the company on whose board he sits unless shareholder approval is obtained.
- A breach of this article may give the company an option of either taking action for damages and interest against the director or demand payment of any profits made by him in contravention of the rule.



# DUTIES OF A GENERAL NATURE

## H. Unfettered discretion

- Not provided for in the Companies Act.
- Directors cannot validly contract with one another or with third parties as to how they will vote at future board meetings or conduct themselves in the future, even if there isn't an improper motive or purpose and even if no personal advantage is to be gained by the directors under this agreement.
- This does not mean that if in the bona fide exercise of their discretion, the directors have entered into a contract on behalf of the company, the directors cannot in that contract validly agree to take such further action as may be necessary to perform the contract.

## I. Duty to promote the well-being of the company

This duty is laid down against a background of a broader statement, also contained in Art.136A(2), that the directors of a company are to promote the well-being of the company and are responsible for the general governance of the company and its proper administration and management; as well as the general supervision of its affairs.

# DUTIES OF SKILL AND CARE

Art.136A(3) specifically obliges directors to exercise “*the degree of care, diligence and skill which would be exercised by a reasonable diligent person having both;*

- I. 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.”*

## Re City Equitable Fire and Insurance Co Ltd

A director need not exhibit in the performance of his duties, a greater degree of skill than may reasonably be expected of a person of his knowledge and experience.

## Dorchester Finance Co vs Stebbing

Subjective test applied to the skill of that particular director, but he was nevertheless required to exercise the diligence that an ‘ordinary man may be expected to take’.

# DUTIES QUA MANDATORY

- \_ Directors are subject to the duties on mandatories in the Civil Code insofar as these do not conflict with the Companies Act.
- \_ One such duty is that of carrying out the mandate so long as the mandatory is vested therewith. The mandatory also has a duty to render account of his management to the mandator. In the case of non-performance of such duty, the mandatory is answerable for damages and interest.



# FIDUCIARY DUTIES

A fiduciary is defined as a person who:

- Owes a duty to protect the interests of another person;
- 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; or
- Receives information subject to the duty of confidentiality and is aware that such information is intended to be confidential.

Fiduciary obligations are set out in the Civil Code. However in reality many overlap with those set out in Article 136A of the Companies Act.

# OTHER STATUTORY DUTIES

- \_ Duties relating to the keeping of statutory registers and minute books
- \_ Duties relating to the filing of returns and documents
- \_ Duties relating to board and general meetings
- \_ Duties relating to record keeping and financial statements
- \_ Duties relating to the liquidation of the company
- \_ Miscellaneous duties

## CSP Regime

- \_ Subject to certain exemptions, a person who by way of business acts as director of a company may qualify as a 'company service provider' under the Company Service Providers Act, thus falling within scope of the MFSA rule book on company service providers.
- \_ Depending on the number of directorships being offered, the director may be required to set up a company and be subject to various ongoing capital, solvency and governance requirements.

# DUTIES OF DIRECTORS OF LISTED ENTITIES

A director sitting on a board of a company that has its securities admitted to listing has a number of additional obligations to comply with. Principally, one must meet continuing disclosure requirements, including:

- A. Company Announcements
- B. Related Party Transactions
- C. Dealing in Securities
- D. Financial Market Abuse (insider dealing, unlawful disclosure of inside information and manipulative practices)

## (A) COMPANY ANNOUNCEMENTS

The Listing Rules provide for a variety of instances in which a company announcement is to be made, including:

- Price sensitive facts which are not public knowledge (inside information);
- Any change in the board of Directors, co-sec or any other senior officer;
- Date of meeting at which dividend is to be proposed by the directors; and
- Planned mergers, amalgamations, disposals or acquisitions; and material changes to capital structure.

## (B) RELATED PARTY TRANSACTIONS

Care must be taken with respect to the effect of related party transactions in the financial position and performance of the company. Audit committee must approve the RPT.

Definition of “related party”:

- A **person** or a **close member** of that person’s family is related to a reporting entity if that person has control, joint control, or significant influence over the entity or is a member of its key management personnel.
- An **entity** is related to a reporting entity if, among other circumstances, it is a parent, subsidiary, fellow subsidiary, associate, or joint venture of the reporting entity, or it is controlled, jointly controlled, or significantly influenced or managed by a person who is a related party.

## (C) DEALING IN SECURITIES

Directors of listed company shall not deal in any of the securities of the company:

- i. When he is in possession of unpublished price-sensitive information in relation to those securities;
- ii. Prior to the announcement of matters of an exceptional nature involving unpublished price-sensitive information in relation to the securities' market price;
- iii. On considerations of a short-term nature; and
- iv. Without giving advance notice to the Chairman.

## D. FINANCIAL MARKET ABUSE

Three main facets:

- I. Insider Dealing;
- II. Unlawful disclosure of insider information; and
- III. Manipulative market practices.

### I. Insider dealing

The **Prevention of Financial Markets Abuse Act** (Cap. 476 of the laws of Malta, the 'PFMAA') and the **Market Abuse Regulations** imposes additional obligations on directors in view of the fact that directors are automatically deemed to be persons in possession of *Inside Information*.



# Insider dealing

## Defined as:

Information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments;

Insider dealing arises where a person possesses inside information and uses that information by acquiring or disposing of, for [their] own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates.

## II. Unlawful disclosure of inside information

Unlawful disclosure of inside information arises where a person discloses inside information to any other person and such disclosure is not made in the normal exercise of his/her employment, profession or duties.

## III. Manipulative market practices

Occurs by virtue of the entry into a transaction which gives or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument or the transmitting false or misleading information