

Award in Company Law Fundamentals

Lecture Title: Share Capital

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Diploma in Law (Malta)



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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

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 vs. issued share 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 Share 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 vs. uncalled capital

Paid-up capital

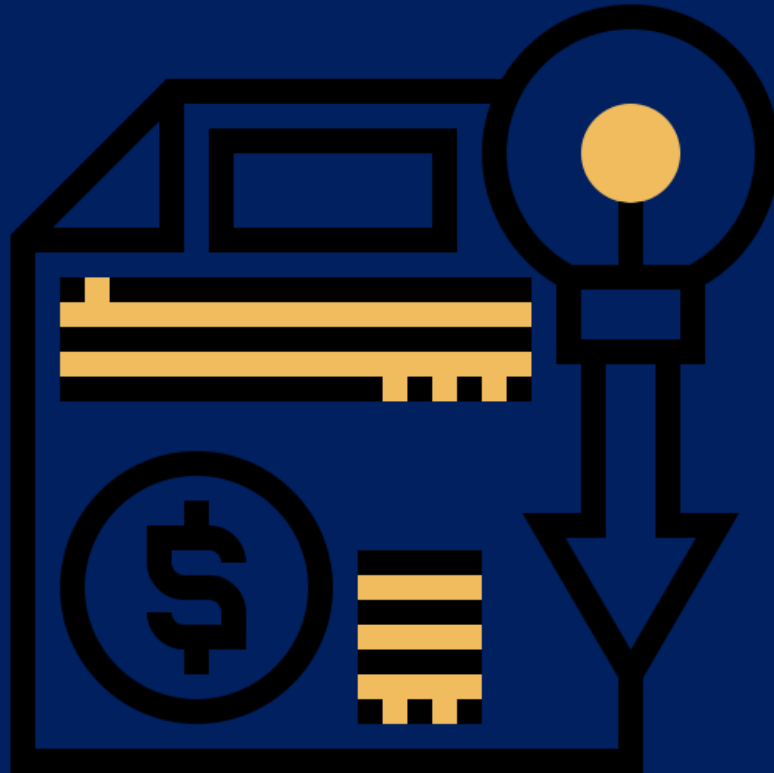
This is the amount of issued capital which is paid up by the shareholders. The amount is calculated by multiplying the number of shares taken by the subscribers with the corresponding amount paid up in the respect thereof.

Uncalled 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.



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%**.

Nominal value

- Nominal value is left to subscribers' discretion
- E.g. EUR 1,200 divided into 1,200 ordinary shares of a nominal value of EUR 1.00 each
- E.g. EUR 1,200 divided into 2,400 ordinary shares of a nominal value of EURO.50c each



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.
- Normally 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.



Preference Shares

- Cumulative

If no dividend is declared in any year, or if declared, is not sufficient to pay the whole of the preferential dividend due, the shortfall must be made up out of profits of subsequent years. The whole of the accumulated dividend is payable to the holder of the shares when the dividend is declared.

- Non-cumulative preference shares

The dividend is only paid out of the profits of the financial year or other period in respect of which the dividend is declared, and if for any reason those profits are insufficient, the shortfall will not be made up in subsequent years.



Redeemable Preference shares

- A company, if duly authorised by its memorandum or articles of association, may issue shares which are to be redeemed or are liable to be redeemed at the option of the company or the shareholder.



Deferred shares

- Shares which qualify for a dividend only when a specified minimum rate of dividend has been paid to the ordinary shareholders.



Convertible shares

- Preference shares may be issued on terms that include an option for the holders, or the company to convert their shares into ordinary shares or on or after a given date or during given future periods



Golden Share

- A special preference share which is able to outvote all other shares in certain specified circumstances.



VARIATION OF CLASS RIGHTS



Variation of 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.



Variation of class rights

The variation of class rights may only be effected subject to the consent of any specified proportion of the holders of the issued shares of that class and of any other class affected thereby or the sanction of a resolution passed at a separate meeting of the holders of those shares and of the holders of any other shares affected thereby



Variation of class rights

The holders of not less in the aggregate than **15% either of the issued shares of that class or of any other class affected thereby**, being persons who did not consent to or vote in favour of the resolution for the change or variation, may by sworn application filed within twenty-one days of the consent or the resolution, demand that the change or variation shall not have effect.



ISSUE OF SHARES



Increase in issued 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).



Issue of shares

- The M&As or an extraordinary resolution may however permit the **board of directors** to issue shares up to a maximum amount. Such permission can be for a maximum period of 5 years, renewable by ordinary resolution for further maximum periods of 5 years.
- The M&As or an extraordinary resolution may also permit the general meeting to authorise by ordinary resolution the board of directors to issue shares up to a maximum amount as may be specified in the resolution. Such



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.

The M&As of private companies may also have clauses providing for pre-emption rights.



Shareholder protection (different classes)

- Where there are several classes of shares, any resolution (referred to in the previous slides) shall be subject to a separate vote for each class of shareholders whose rights are affected by such resolution, and the provisions relating to the majority required for the resolution shall apply for each class



Alterations to the constitutional documents

- Alterations to the memorandum of association may be required to increase the authorised share capital



Issue of shares at a premium

- Shares are sometimes issued at a premium i.e. for a consideration which is higher than their par value
- E.g. a share with a nominal value of EUR 1.00 may be issued for EUR EURO.50c.



Filings

- ✓ a copy of the ordinary or extraordinary must be delivered to the Registrar of Companies
- ✓ Form H (return on allotments)
- ✓ Form B02
- ✓ Expert's report (issue of shares other than in cash)
- ✓ Deposit slip (issue of shares in cash)
- ✓ Tax filings





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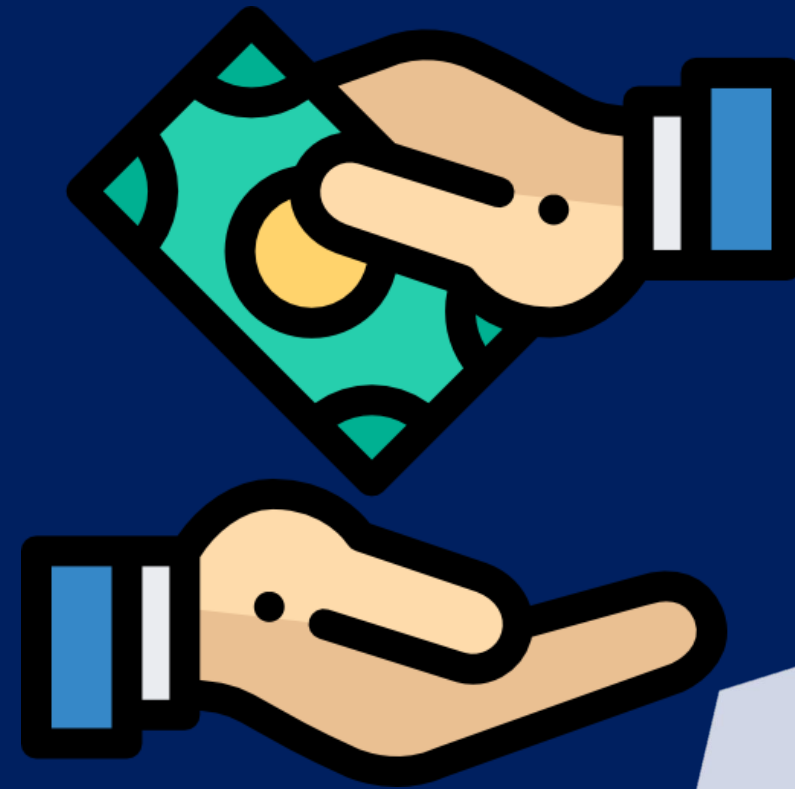
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PLEDGING OF SHARES



A pledge over shares confers upon the pledgee (that is, the creditor) the right to obtain payment out of the shares with privilege over other creditors. The debt due to the pledgee constitutes a privileged debt over the pledged shares.

Article 122 of the Companies Act



Public and Private companies

Public company

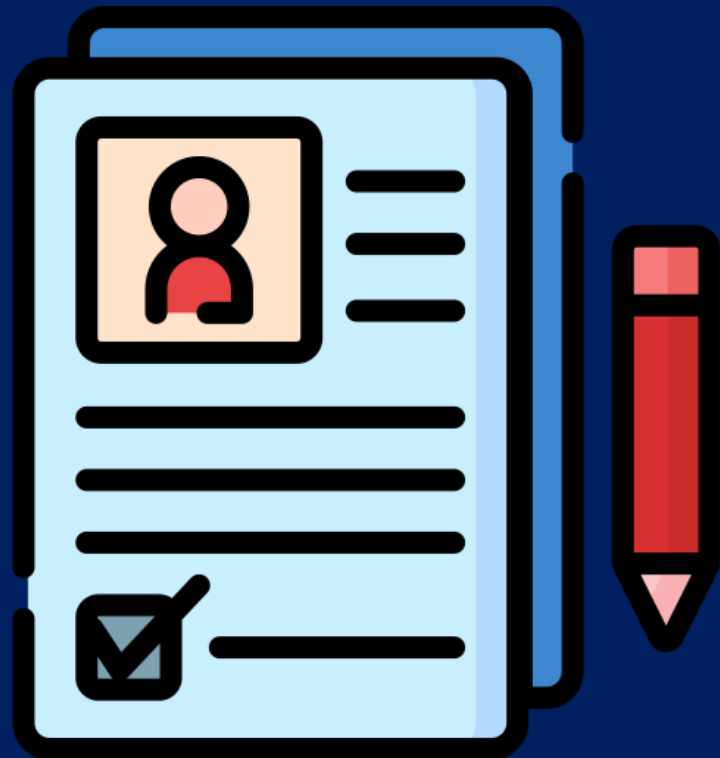
Shares in a public company may generally be pledged unless otherwise provided in the M&As of the company or under the terms of issue of the shares.

Private company

In the case of a private company, shares may not be pledged unless the M&As of the company specifically allow it.



Publication of the Pledge



- The company needs to be notified of the shares being pledged within **14 days of the granting of the pledge**
- Notice of the pledge must also be delivered to the Registrar **within 14 days (From T(2)) by the pledgor or the pledgee**
- The company whose shares have been pledged should also record the pledge in the register of members

The pledge is not regarded as effective until the registration by the Registrar of the notice of the pledge.

Terms of the Pledge Agreement

The pledge agreement may specify who is to exercise all the rights belonging to the shareholder during the duration of the pledge, including voting rights and dividend payments.

If the pledge is silent:

1. All rights of the holder of shares will be exercised by the pledgor until such time as he defaults under the agreement of pledge or until the pledgee enforces his security;
2. Unless the pledgor and the pledgee have otherwise agreed in the pledge agreement and notice thereof has been given to the company, dividends or interests payments due on securities which are pledged shall, during such time as the pledge is registered in the register of holders of the respective securities, be paid by the company to the pledgee who shall appropriate any such amounts received to the interest due on the debt secured by the pledge, and, if there is an excess, to the capital.



Deliverables of the Pledge Agreement

1. Undated share transfer instruments;
2. Undated director resignations;
3. Annotated share transfer instruments;
4. Notice upon an issue of shares
5. Undertaking that any further shares so issued will be pledged and annotated share certificates and undated share transfer instruments would be delivered to the pledgee.



Termination of the Pledge

Notice of termination should be delivered by the pledgee to the Registrar within **14 days** from the termination (Form T3).

- The company and the regulated market, if applicable, should also be notified of the termination.



Transfer of pledged shares

Any transfer or assignment of the pledged shares without the **consent** of the pledgee is null and void.

If consent is given, the transfer or assignment will be valid but the shares will remain subject to the pledge.



Payment out of the shares pledged

The creditor has both the right to apply for a judicial sale of the shares as well as the right to dispose or appropriate the shares in the event of a default under the agreement of the pledge.

The pledgee is obliged to notify the pledgor prior to this by means of a judicial act.



Price of shares to be disposed of or appropriated

The value of the shares may be established by agreement between the pledgor and the pledgee as long as this is done **after** notice of default would have been given.

Failure to reach agreement the value will be determined by a certified public accountant or an auditor appointed by the Court on the application of the pledgee



Additional conditions for pledge of shares

Prior to exercising the right to dispose of or appropriate the shares, the pledgee must offer the shares to the other shareholders of the company as follows:

- If the M&As of the company lay down pre-emption rights relating to the transfer of shares, then the shares must be offered by the pledgee in accordance with those rights
- If not, the shares must be offered by the pledgee to all the other shareholders of the company in proportion to their holdings.

In the case of a **public company** the pledged shares have to be offered to shareholders of a company on a pre-emptive basis only if the M&As of the company include pre-emption rights.



Financial Collateral Regulations

- These regulations apply to collateral arrangements constituted over cash, instruments and credit claims.
- They apply to certain entities (credit institutions, insurance undertakings, investment services providers, financial institutions and non-natural persons in certain circumstances).
- Abolishes many formal requirements, improves enforcement rules, in or outside insolvency.



Financial Collateral Regulations – noteworthy provisions

1. A financial collateral arrangement is valid in accordance with its terms
2. Pre-emption rights in the Companies Act do not apply
3. Enforcement is made without formal requirements
4. Enforcement takes place notwithstanding insolvency



Financial Collateral Regulations – enforcement

Financial collateral arrangement shall be valid and enforceable in accordance with its terms notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker.



CAPITAL MAINTENANCE



Capital maintenance

The single greatest advantage of trading through a company is the limited liability afforded to its members.

In order to secure this advantage, companies face additional disclosure requirements and have to follow the rules on **capital maintenance**, which prevent the members withdrawing their capital without restriction.



The rules making up the Capital Maintenance Doctrine

1. A company may not purchase its own shares or redeem its preference shares except under the strict conditions laid down by law;
2. A company may not give any kind of financial assistance for the acquisition of its own shares except in the particular circumstances set out in the law;
3. As a rule, a reduction of share capital can only be effected subject to certain strict conditions; and
4. Dividends may only be paid from the distributable profits of the company.





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