

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 funds borrowed by the company. In contrast to share capital, loan capital represents rights against the company.

Loan Capital

- Loan capital is money that is borrowed from others, either individuals or banks, to make an investment.
- Loan capital can take the form of loans, credit cards, overdraft agreements, and the issuance of debt, such as bonds.
- The interest rate is always the cost of borrowed capital.



Share capital

- Share capital is the money a company raises by issuing ordinary or preference shares.
- Equity is money the company already has in its coffers or which it can raise from would-be owners or investors.



Share capital

- Authorised share capital
- Issued share capital
- Paid-up capital



Authorised and issued share capital

- Authorised share capital

Authorised share capital is the total of the nominal value of the shares which a company may issue. The authorised share capital is the figure which appears in the capital clause of the company's memorandum of association.

- 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 share capital which is actually issued and taken up by the shareholders.



Paid-up 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 up by the subscribers with the corresponding amount paid up in respect thereof.

E.g. 10,000 shares having a nominal value of €1.00 (20% paid-up). The total paid-up share capital is €2,000.



Minimum capital amounts



- **Private company** → €1,164.69
- Not less than 20% of the nominal value of each share taken up must be paid up on the signing of the memorandum of association
- **Public company** → €46,587.47
- Not less than 25% of the nominal value of each share taken up must be paid up on the signing of the memorandum of association

Nominal value



The nominal value is left to the subscribers' discretion.

- E.g. €1,200 divided into 1,200 ordinary shares of a nominal value of €1.00 each
- E.g. €1,200 divided into 2,400 ordinary shares of a nominal value of €0.50 each.





Classes of shares

Classes of shares

- A company having a share capital may have separate classes of shares. A type of share will form a separate class if the rights attached to it differ from those attaching to other shares of the company.
- The class rights need to be included in the memorandum of association.



Classes of shares

- 1. Ordinary Shares
- 2. Preference Shares
- 3. Deferred Shares
- 4. Convertible Shares



Ordinary Shares

- Every company is required to have ordinary shares. When a company only has one class of shares, these shares will be regarded as “ordinary shares”. These shares will have the same nominal value and the same rights attaching to them.
- Typically, the rights attaching to ordinary shares are the following:
 1. Voting rights;
 2. Rights to dividends;
 3. Rights to share in the assets of the company during a winding-up.
- Ordinary shareholders will share in the profits and the return of capital after the preference shareholders have been paid.



Preference shares

- Preference shares are those shares which entitle their holders to a preference over ordinary shares in respect of dividends and the repayment of capital on a winding-up.
- This preferential treatment does not necessarily mean that a preference shareholder will always receive the payments due to that holder. This is because dividends are only payable if there are sufficient profits available for distribution.



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.



Preference shares

- Redeemable preference shares

If duly authorised by its memorandum or articles of association, a company 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 share which gives its holder veto rights over all other shares in certain specified circumstances.





Variation of class rights

Variation of class rights

- The memorandum and articles of association must specifically provide for the ability of the classes of shares to be varied.
- The variation of class rights may only be made 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 21 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 in issued share capital is to be decided upon by an **ordinary resolution** of the company unless the memorandum and articles of association require a higher percentage than that required for an ordinary resolution.
- 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 50% 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.



Increase in the issued share capital

- The memorandum and articles of association of the company 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.



Offer of shares on a pre-emptive basis

- Whenever 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 an 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.



Alteration of the constitutional documents

- An increase in the issued share capital cannot exceed the authorised share capital
- Alterations to the memorandum of association may 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 nominal value
- E.g. a share with a nominal value of €1.00 but shareholders subscribe for that share for the subscription price of €1.50. The amount of €0.50 represents the premium payable on the issued share.
- Share premium is transferred to a share premium account which has specific uses in terms of the Companies Act.



Issue of shares at a discount

- The authority to issue shares at a discount must be included in the memorandum and articles of association.
- The discount cannot exceed 10% of the price at which the shares are issued or the amount authorised by the memorandum or articles, whichever is less.
- If the shares offered at a discount are offered to the public, the discount and the conditions of eligibility for the discount must be disclosed in a prospectus. If they are not offered to the public, the discount must be disclosed in a statement signed by the directors and delivered to the Registrar of Companies. Where a notice or circular issued (not being a prospectus), the discount and the conditions of the discount must be disclosed in the notice or circular.
- In no event may the value of the shares be reduced to below the nominal value as a result of the discount.

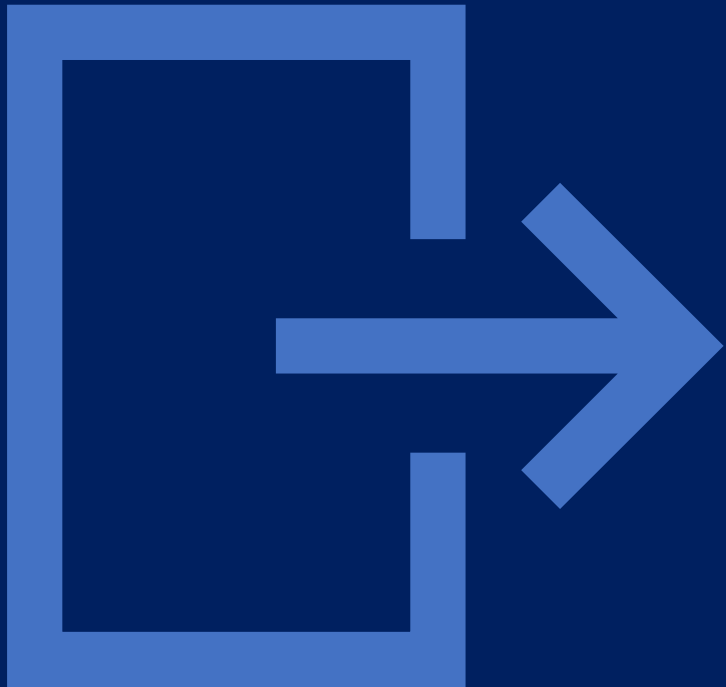


Filings

Filings

- ✓ A copy of the ordinary or extraordinary resolution 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)
- ✓ Summary of contract (other than in cash)
- ✓ Deposit slip (issue of shares in cash)
- ✓ KYC documentation of new shareholders
- ✓ Tax filings





Transfer of shares

- Instrument in writing (does not apply to shares held or evidenced in a dematerialised form or represented in book-entry form as immobilisation)
- Instrument in writing or an authentic copy thereof must be delivered to the company
- Name and address of the transferee included in the register of members



Filings

- Form T
- Form B02
- Tax filings



Pledging of shares

- A pledge over shares confers upon the pledgee (i.e. 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 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 so pledged within **14 days** of the granting of the pledge.
- Notice of the pledge must also be delivered to the Registrar within 14 days (Form T2) 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 against third parties until the registration by the Registrar of 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:
 - a. 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;
 - b. Unless the pledgor and the pledgee have otherwise agreed in the pledge agreement and notice thereof has been given to the company, dividends or interest payments due on shares which are pledged shall, during such time as the pledge is registered in the register of holders, 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 excess, to the capital.



Deliverables of the pledge agreement

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



Termination of the pledge

- Notice of the 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 pledged shares

- 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 on the value will be determined by a certified public accountant or an auditor appointed by the court or 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 shareholder of the company as follows:

- If the M&As of the company lay down pre-emption rights relating to the transfer of shares, the shares must be offered by the pledgee in accordance with those rights.
- If the M&As are silent, 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 the shareholders of the 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 of the pledge 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 of the collateral provider



Filings

- Form T2 – constitution of pledge
- Form T3 – termination of pledge



Capital maintenance doctrine

- The objective underlying the capital maintenance doctrine is the protection of creditors
- The law protects creditors by limiting the dissipation of assets to shareholders and by circumscribing the circumstances in which capital can be returned to shareholders

Four fundamental principles

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





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