

Company Law Fundamentals

Lecture Title: Share Capital

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Diploma in Law (Malta)



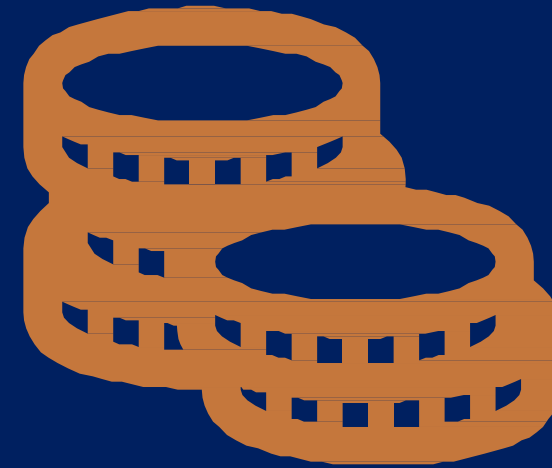
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Introduction

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 the borrowed capital.



Share Capital

Share capital is the money a company raises by issuing ordinary or preference shares.

Three aspects to consider:

- Authorised Share Capital
- Issued Share Capital
- Paid-up Capital



Authorised share capital

Authorised Share Capital

- Authorised share capital is the total of the nominal value of the shares which a company may issue. It represents an authority to create new capital through the issue of new ordinary shares. A company cannot issue shares in excess of its authorised share capital.

€15,000,000 divided into 15,000,000 ordinary shares of €1.00 each. 1,000,000 shares are issued.



Issued Share Capital

This is the total of the nominal value of the shares which is 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 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 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





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.

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.



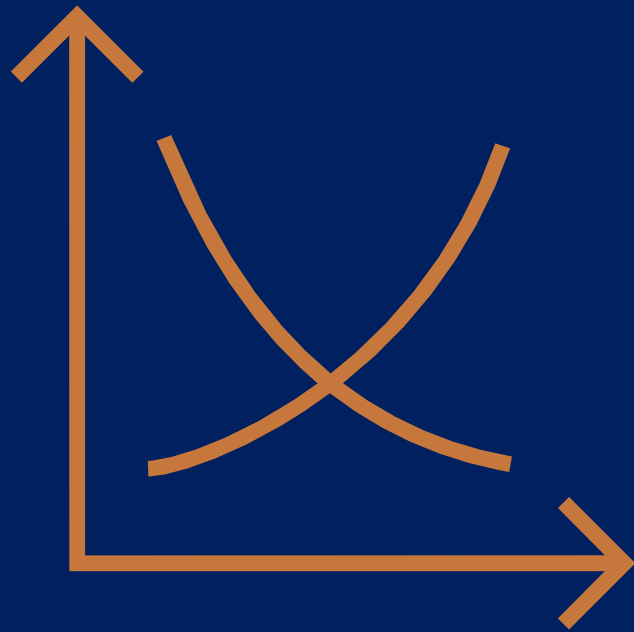
Variation of Class Rights

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.

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 the 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 memorandum and articles of association 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

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 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.

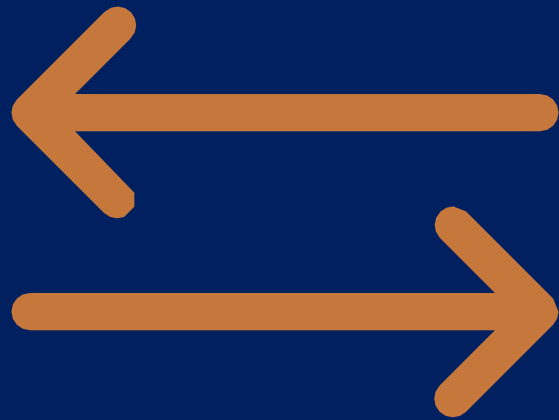
Share premium is transferred to a share premium account which has specific uses in terms of the Companies Act.



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

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
- KYC documentation of new shareholders
- Tax filings





Pledging of Shares

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



Pledging of shares

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 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 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.
- **Companies Act provisions*



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. These rules are there to curtail abuse where the pledgee opts to appropriate the shares rather than apply for the judicial sale of the shares.

Should the parties fail to agree on the valuation, the fair value will be determined by a certified public accountant or a certified public accountant and auditor appointed by the First Hall, Civil Court or the application of the pledgee.

The fair value of the shares should be determined with reference to the date of the judicial act notifying the pledgor of the event of default.

**Companies Act provisions*



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.

**Companies Act provisions*



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 notwithstanding the commencement of winding-up proceedings

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 the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker

Filings

- Form T(2) – constitution of pledge
- Form T(3) – termination of pledge





Capital Maintenance Doctrine

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 ahead of the company's winding up.



Four fundamental principles

1. A company may not purchase its own shares or redeem its preference shares except under the strict conditions laid down by the law.
2. 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.
3. A reduction of share capital can only be effected subject to certain strict conditions.
4. Dividends may only be paid from distributable profits of the company.



1. Share repurchases

Article 105: General Rule

- Prohibition from subscribing to own shares on original or subsequent subscription
- Actions to the contrary will have consequences

Article 106: Exception

- A company may acquire its own shares other than by subscription, as long as a number of stringent conditions are followed.

Article 107: Buy-back Outside The Scope Of Art.106

- This article allows for special circumstances where the company may acquire its own shares other than by subscription, and may do without most of the conditions mentioned in art.106.



1. Share repurchases

Article 105: General Rule

Should a company subscribe for its own shares in contravention of Article 105:

- If the shares were subscribed to on original subscription, the members of the company will be jointly and severally liable to pay for the shares subscribed in contravention of the article;
- 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 the general rule 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.

In view of the above, the effect of contravention of the provision in the Companies Act prohibiting the subscription of shares is not nullity.



1. Share repurchases

Article 106: Exception

A company “may acquire its own shares other than by subscription” **as long as a number of stringent conditions are followed:**

- The Memorandum or Articles must authorise the company to acquire its own shares;
- Authorisation is given by an extraordinary resolution (which must be registered with the MBR)



1. Share repurchases

Article 106: Exception

However

- The nominal value of the acquired shares, including shares previously acquired and held by the company may not exceed 50% of the issued share capital
- The company may not acquire its own shares 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 the called up issued share capital plus those reserves which may not be distributed under the provisions of the Companies Act or the company's memorandum or article
- The shares acquired must be fully paid up shares



1. Share repurchases

Article 106: Exception

- In any case, a company may only acquire its own shares out of the proceeds of a fresh issue of shares made specifically for the purpose, or out of profits available for distribution, and
- A company may not as a result of the acquisition of its shares become the only holder of its ordinary shares.



1. Share repurchases

Article 7: Buy-back Outside The Scope Of Art.106

A company may acquire its own shares other than by subscription and may do without most of the conditions mentioned in art.106 – the only prohibition being that the company may not become the sole holder of its ordinary shares. Examples of an A.107 share buy-back include where:

- the shares are acquired by the company in the course of a reduction of the issued share capital; or
- where the shares are forfeited or surrendered to the company

Within the majority of these special circumstances, the company is allowed to hold on to the shares for a 30 month period which starts to lapse from the date of acquisition. If the company fails to dispose of the shares within this period, it is bound to pass an extraordinary resolution cancelling the shares.



1. Share repurchases

Reasons for share buy-backs

1. To return value to shareholders
2. To reduce the share capital
3. Deadlock situation between shareholders



2. Financial assistance

It is prohibited for any company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of an acquisition or subscription made or to be made by any person of or for any shares in the company or its parent company.

In the case of a private company, it is possible to “whitewash” financial assistance by following the procedure set out in Article 110(4) of the Companies Act.



3. Reduction of share capital

Since the process of reduction of share capital is another fundamental rule of capital maintenance, one is prima facie led to believe that the law prohibits such a process.

However, this is not the case and since there are various reasons why a company would want to reduce its share capital, the law has set out a number of conditions with which a company must abide in order to be able to reduce its share capital.



3. Reduction of share capital

Why would a company want to reduce its issued share capital?

1. A reduction of share capital can be made to offset losses, with the effect that distributable reserves of a company will be positively effected. It creates a reserve which is treated as a realised profit for accounting.
2. To return surplus capital
3. To facilitate a share buy-back or a redemption of preference shares



3. Reduction of share capital

Capital reduction procedure (Art. 83)

1. The reduction must be permitted
2. An extraordinary resolution must be passed to approve the reduction
3. The reduction takes effect only after 3 months from the date of a publication of a statement on the reduction in the Government Gazette or on the website maintained by him and in a daily newspaper, that he has received the resolution for registration. During that three-month period, any creditor of the company whose debt existed prior to the publication of the statement may object to the reduction by filing judicial proceedings.



4. Dividend distributions

It is only out of distributable profits that dividends may be paid.



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