

Module 03 – Company Law Fundamentals

Lecture Title: Corporate Governance, meetings and resolutions

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Overview

1. Basic principles and issues in corporate governance
2. Decision making: Shareholder meetings & resolutions
3. Principle of majority rule and minority rights
4. Decision making: Board meetings & resolutions



Definition of Corporate Governance

“Corporate governance is the system by which companies are directed and controlled, and to what purpose.”

Source: Sir Adrian Cadbury, UK Combined Code

“Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders.

Source: OECD Corporate Governance Principles, 2004



Definition of Corporate Governance

In corporate governance, the focus is on:



Structure

Process

Value

Essentially, it is about:

- which body/ies within the company has the power to make decisions;
- how are members of this body chosen and how do they take decisions; and
- what values should guide their decision-making.

Interplay between company law and corporate governance

- It is important to situate the subject of corporate governance against the backdrop of company law. Where does company law end and corporate governance begin?
- If company law is the **hardware** and the operating system, corporate governance can be described as the **APPS** running on the hardware.
- In other words, corporate governance supports and complements company law which is the framework.



Interplay between company law and corporate governance

<p>Corporate Governance</p> <p>EX ANTE MEASURES</p> <p>E.g. Non-executive directors, audit committee</p>	<p>Company law</p> <p>EX POST MEASURES</p> <p>e.g. Liability issues</p>
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The basic relationships of a company

At this stage, we should recall the basic relationships of a company, where shareholders

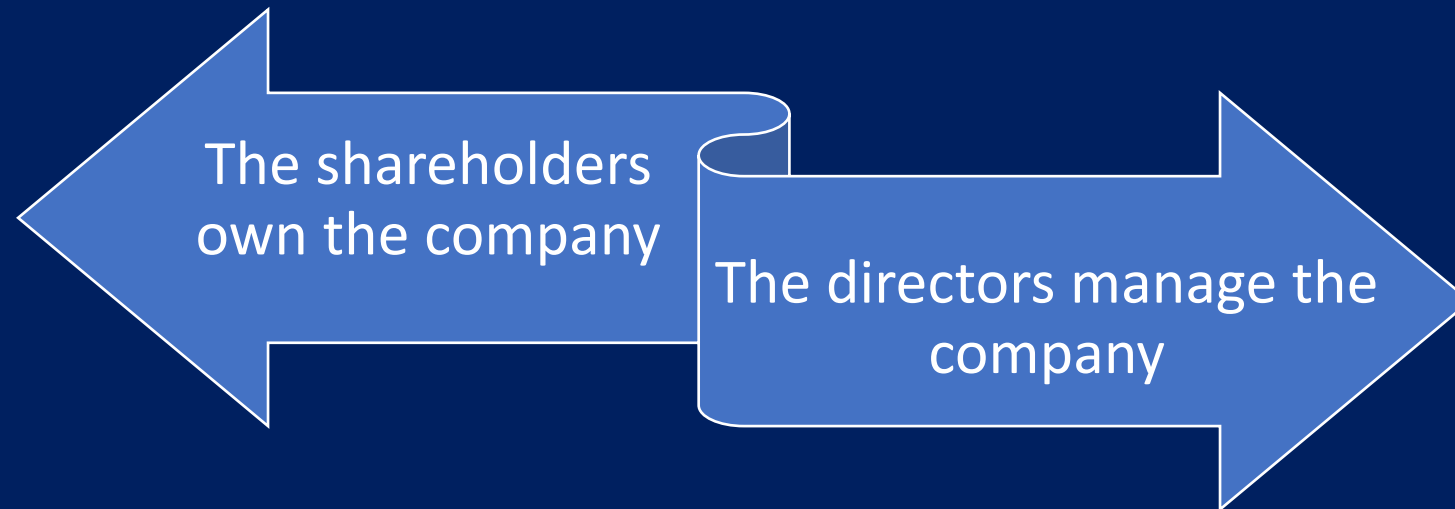
- inject their capital;
- set out a number of objects that are to be attained by the use of that capital;
- and then entrust that capital to the directors with a view to attaining those objects.

Keeping this in mind, there can be no doubt that the directors ought to exercise their skills to achieve the objects set out in their mandate – the primacy of creating and adding shareholder value is inherent in the very underlying fabric of the company and its incorporation.



Shareholders vs. Directors

Shareholders and directors have two completely different roles in a company:



Shareholders vs. Directors – distribution of powers

The directors are vested with the “residual powers” of the company: the directors may exercise all the powers of the company except those which are required by the Companies Act or by the M&A to be exercised by the general meeting.

Ultimately, control vests in the shareholders, by virtue of their power to:

- i. Amend the M&A of the company; and
- ii. The power to remove directors.



Corporate Governance Issues

- Corporate governance is principally concerned with the consequences of the separation (or otherwise) of ownership and control – the Agency Problem.
- Whatever the ownership-control structure, various issues relating to governance of the company arises.
- **Agency problems** = 3 main conflicts:
 1. Among shareholders
 2. Between shareholders and management; and
 3. Between the company itself and other constituencies of the company (including employees and creditors).



The Agency Problem

Small private limited liability
company

Concentrated ownership structure
(Malta)

Ownership and control are united

Agency problem between
shareholders, in the form of
expropriation by the majority of
interests of the minority

Publicly traded company

Dispersed ownership structure
(UK, US)

Ownership and control are
separated

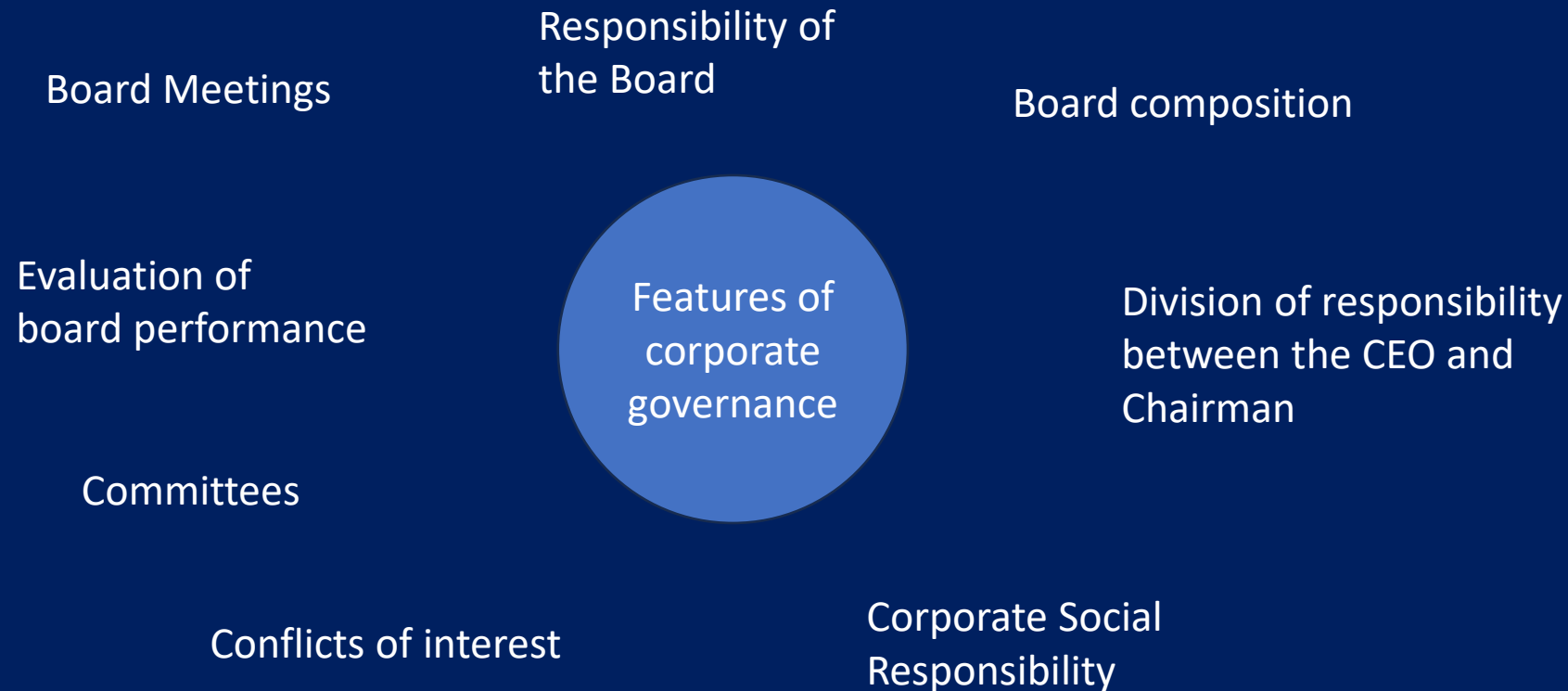
Agency problem between
management and shareholders – in
the form of expropriation by insiders

Corporate Governance in Malta

- Concentrated ownership structure → Minority Oppression → Minority Shareholder Remedies
- In Malta, corporate governance is “principle-based” – based on a code of corporate governance principles of good practice, resulting in a “comply or explain” approach.
- The Code of Principles of Good Corporate Governance (Appendix 5.1 of the Capital Markets Rules issued by the Malta Financial Services Authority) applicable to listed companies.
- Statement of compliance (or otherwise) must be included in the listed company’s annual report.
- Narrow conception of corporate governance: only concerns listed companies. Wider conception of corporate governance: many issues of corporate governance affect all companies whatever their size and nature.



Corporate Governance in Malta





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Decision making: Who? When? How?



Decision making:

Who?

Shareholders

Board of directors

When?

Annually

Any time

How?

Physical

Writing

Decision making:

A company acts through two principal organs, at their respective meetings:

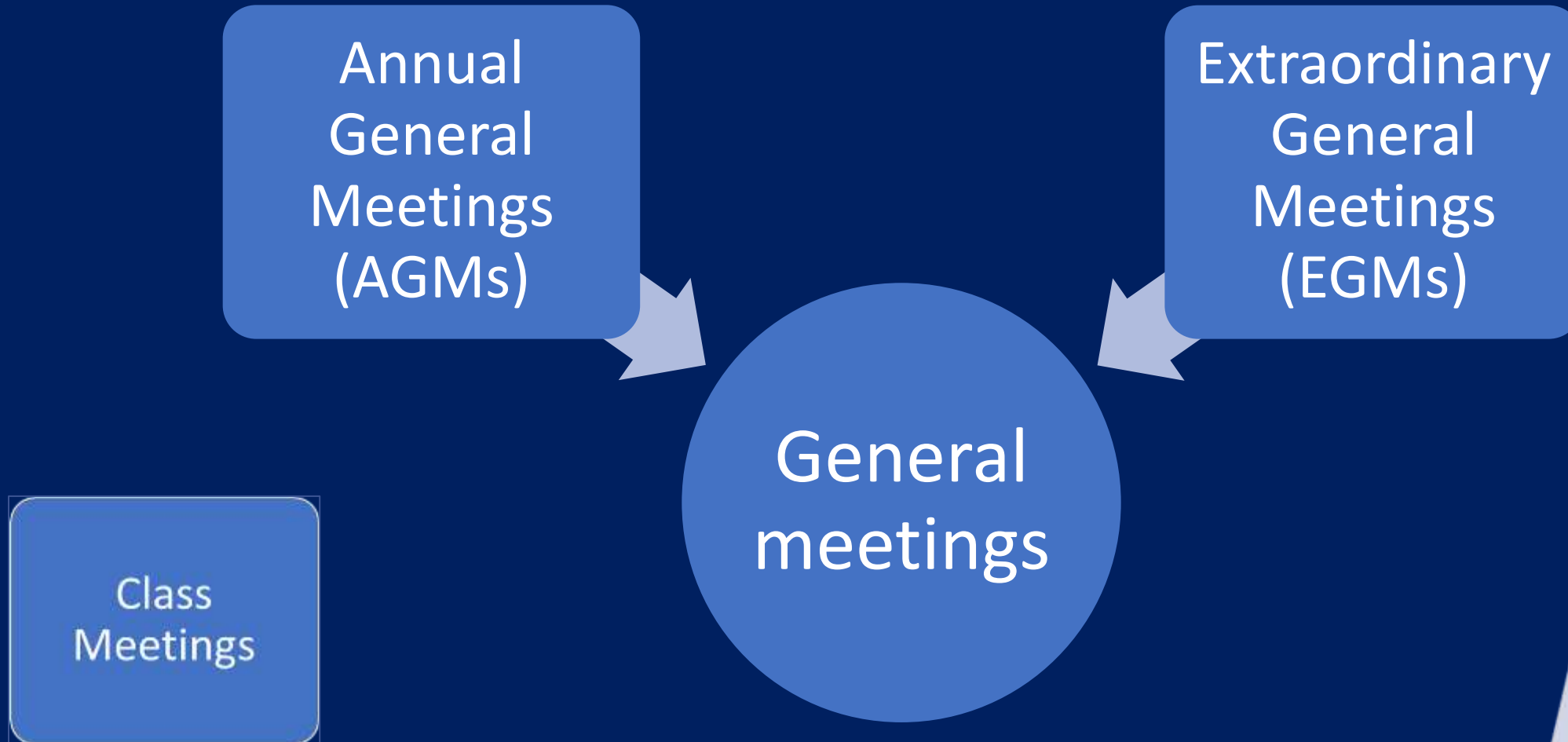
1. the body of shareholders – acts through the general meeting
2. the board of directors – acts through board meetings



Shareholder decision-making



Shareholder meetings



Annual General Meetings

When?

- Held once a year

Purpose?

- Accountability of directors
- Approval of accounts and reports
- Appointment of auditors
- Approval of dividends

Annual General Meetings: Business transacted

The Companies Act does not stipulate what business is to be transacted at an AGM. The First Schedule to the Companies Act provides an indication of the ordinary business to be transacted at an AGM.

Unless the Articles of Association provide otherwise, the ordinary business conducted at an AGM is:

- i. The declaration of dividends, if any
- ii. The consideration of the audited accounts and the reports of the directors and auditors
- iii. The election of directors in place of those retiring and
- iv. The appointment and fixing of the remuneration of the auditors.



Annual General Meetings: Circulation of accounts

The company, usually through its company secretary, is required by the Companies Act to ensure that not less than 14 days before the date of the AGM at which the annual accounts are laid, a copy of the accounts is to be sent to:

- (i) every shareholder;
- (ii) every debenture holder; and
- (ii) all other persons who are entitled to receive notice of general meetings.



Extraordinary General Meetings

When?

- ✓ An EGM may be convened at any time on the demand of:
 - The Board; or
 - The Shareholders having at least 1/10th of the paid-up share capital of the company carrying voting rights
 - Others (by the Court or the Auditors)

Purpose?

- ✓ For the matters and business specified in the notice calling the extraordinary meeting.

EGM or AGM

Two particular matters that shall be considered at an EGM:

1. Decision to be taken in the course of a company recovery procedure (CRP);
2. Where a resigning auditor requisitions an EGM for the purpose of explaining the reason for this resignation.

There are of course several other matters which require consideration and decision at an EGM or an AGM, including:

- Alterations to M&As,
- conversion, amalgamation or division of a company;
- dissolution of a company and filing for winding up;
- filing for CRP;
- review of financial position when company is unable to pay debts;
- **AND other matters which the board may, in terms of law or the M&As, lawfully refer to the general meeting.**



Class Meetings

- A class meeting is called and held for the benefit of its members, holding shares of a particular class of shares, often in response to a proposal to vary class rights.
- Resolutions that are passed will only bind the members of that class, and only those members may attend, speak and vote at such meetings.



Class Meetings

Class meetings may be held:

- To approve of alterations to the rights of the particular class under the M&As;
- To approve a reduction in share capital;
- To approve an increase in the issued share capital;
- To appoint directors (where the holders of a class have that right);
- To approve of compromises or arrangements which affect the particular class;
- To approve the amalgamation of the company;
- To approve the division of the company.



Convening of General Meetings

- ✓ Sufficient notice must be given in writing specifying the date, time and location
- ✓ Notice must be sent to: (i) every shareholder (irrespective of right to vote); (ii) the company's auditors (in the case of an AGM); and (iii) the directors
- ✓ Supporting documentation to be circulated together with the notice.

Typically,
14 day
period

21 day for
listed
companies



Meetings generally

Agenda

- An agenda should also be circulated, giving sufficient detail to allow shareholders, or their proxies, to decide whether or not they need attend

Quorum

- Unless the M&As provide otherwise, members present in person or by proxy holding in aggregate not less than 1/10th of the paid up share capital of the company carrying the right to attend and vote at general meetings of the company at the date of the holding of the meeting, shall be a quorum.



Meetings generally

Proxies

- Every member may appoint another person as his proxy to attend and vote instead of him
- The notice of the meeting must inform members of this right

Voting

- Voting may take place by (i) show of hands or (ii) a poll
- Show of hands: 1 member = 1 vote
- Poll: 1 share = 1 vote

Chairman

- Chairman conducts the meeting, and is typically the chairman of the Board of Directors





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Shareholders' Resolutions: Extraordinary and Ordinary



Resolutions: Extraordinary

Extraordinary Resolutions

1. A notice specifying the intention to propose an extraordinary resolution and:
2. Quantum of votes:

In the case of PUBLIC COMPANIES:

- Approval by member(s) holding = / > 75% in nominal value of shares represented and entitled to vote at the meeting; and
- Approval by members holding = / > 51% in nominal value of all shares entitled to vote, or such higher % prescribed in M&As

In the case of PRIVATE COMPANIES:

- = / > 51% in nominal value of shares entitled to vote at the meeting, or such higher % prescribed by the M&As.



Resolutions: Ordinary

Ordinary Resolutions

Must be passed by a member(s):

- Having the right to attend and vote;
- Holding in aggregate more than 50% of the voting rights attached to the shares represented and entitled to vote at the meeting (unless the M&As require a higher %).

For	Against

Ordinary or Extraordinary Resolution?

The nature of the decision taken

It is not dependent on the **type of meeting (AGM/EGM)** at which it is made. Rather it depends on the **nature of the decision** to be taken.

Both types of resolutions can be passed at either kind of general meeting: extraordinary resolutions may be taken at AGMs and ordinary resolutions may be taken at EGMs, and *vice versa*.

Ordinary or Extraordinary Resolution?

The Companies Act reserves certain decisions to be taken by extraordinary resolution

- ✓ Alterations to M&As
- ✓ Acquisition of own shares
- ✓ Variation of voting rights
- ✓ Voluntary winding-up or winding-up by Court
- ✓ Nomination / removal of liquidator
- ✓ Conversions to commercial partnerships
- ✓ Merger / amalgamation and division of companies

All other decisions may be taken by way of any ordinary resolution, unless the company's M&A require an extraordinary resolution.



Ordinary or Extraordinary Resolution?

Shareholder reserved matters in shareholders' agreements and/or M&As:

Resolutions to be unanimously approved or to be approved by a higher % of votes than would normally otherwise be required.



Shareholders' Resolutions in writing

Insofar as PRIVATE companies are concerned, the Companies Act provides that:

A resolution in writing is as valid and effective as if the same had been passed at a general meeting of the company duly convened and held”

...but can any resolution be made in writing?

YES...except for any decision purporting to:

- Remove a director or an auditor before the expiration of his term of office; or
- Deprive the company's auditors of their right to receive notice of, and to attend and to be heard at, general meetings of the company.

Resolutions in writing would need to be signed by all shareholders having the right to receive notice of and attend and vote at general meetings



Shareholders' Resolutions in writing

The M&As of a PUBLIC company typically provide that: A resolution in writing is as valid and effective as if the same had been passed at a general meeting of the company duly convened and held

If not specified in the M&As, the resolutions would need to be passed through general meeting.





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The Principle of Majority Rule and the Protection of Minority Rights



Majority rule and minority rights

Majority rule means that power resides, principally, in the hands of those who own more than half the shares with voting rights.

Without the majority rule principle, companies wouldn't prosper.

The minority shareholders would have to accept the decision of the majority as a matter of business necessity, or may otherwise seek to reverse the decision through normal democratic processes (of persuasion, lobbying, publicity etc) or sell out.



Majority rule and minority rights

Minority shareholders of small private companies are typically locked in by virtue of:

Preemption Clauses

Other restrictions
on transfer

Majority rule and minority rights

Majority rule

The majority of the shareholders hold the decision making power of the company

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

Minority rights

General rule of Foss vs. Harbottle

- The position in Malta reflects that in the UK, which is enshrined in the judgment of Foss v Harbottle (1843)
- The general rule is composed of two limbs:
 - 1) Where a wrong is done to the company, the proper plaintiff is, *prima facie*, the company itself
 - 2) Where the wrong or irregularity could be made binding on the company by a simple majority of the votes of its members, no individual member may maintain an action in respect of the wrong or irregularity.

The derivative action: one exception to the general rule

- The derivative action is an action brought by a shareholder in connection with a wrong done to the company, where the wrongdoers are in control and prevent the company itself from bringing a claim.
- Minority shareholder must prove:
 - ✓ Fraud on the minority and
 - ✓ Control of the wrongdoer which prevents the company from instituting the action in its own name



Statutory remedies under Maltese law

- There are two principal remedies under Maltese law:
 - 1) Unfair prejudice action (Article 402 of the Companies Act)
 - 2) Winding up of the company

Unfair prejudice action

- *Any member of a company who complains:*
 - (i) *that the **affairs of the company** have been or are being or are likely to be conducted in a manner that is, or*
 - (ii) *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.



Unfair prejudice action

If the Court considers it just and equitable to do so, the Court may issue seven different types of orders, on terms it considers fit:

1. Regulate the conduct of the company's affairs in the future
2. Restricting or forbidding the carrying out of any proposed act
3. Requiring the company to do an act which the applicant has complained it has omitted to do
4. Provide for the purchase of the shares of any member by other members or by the company itself



Unfair prejudice action

5. Derivative action: directing the company to institute, defend, continue or discontinue court proceedings, or authorising a member or members of the company to institute, defend, continue or discontinue court proceedings in the name and on behalf of the company
6. Provide for the payment of compensation for loss and damage as a result of act or omission complained of
7. the company and providing for its consequential winding up



Winding up of the company

A shareholder may file a request for the dissolution and winding up of the company (winding up application) for an order that there are **grounds of sufficient gravity to warrant the dissolution and consequential winding up of the company.**

Article 214(2)(b)(iii): “grounds of sufficient gravity” situations:

- Disappearance of the substratum (purpose)
- Deadlock
- Justifiable loss of confidence in management
- Exclusion from management
- Oppression, unfair prejudice, unfair discrimination



Unfair prejudice v Winding up remedy

Interrelationship between the winding up remedy under the unfair prejudice provision and the “grounds of sufficient gravity” basis for winding up:

Unfair prejudice remedy

- ☹ An article 402 winding up order can only be made in the case of conduct, act, omissions which have been or are likely to be oppressive, unfairly discriminatory or unfairly prejudicial to a member(s). And only if the court considers it “just and equitable” that the company be dissolved and wound up.
- ☹ Variety of potential remedies if the court considers dissolution to be too draconian.

“Grounds of sufficient gravity” winding up

- ☺ Grounds on which a winding up order can be made under Article 214(b)(iii) are wider. The court is not limited by the “unfair prejudice” requirements.
- ☹ Dissolution and winding up is the only remedy.





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Board decision making



Board meetings

The powers of directors are exercised through board meetings

There are less stringent rules regulating the convening of board meetings...why?

- Directors, unlike shareholders, are deemed to be aware of the financial position of the company;
- Urgent board meetings may need to be held; and
- Meetings need not be formal



Board meetings

Convening a Board meeting

- No rule in the Companies Act, but the Model Articles provide that the directors may summon a meeting at any time
- The company secretary may also summon a Board meeting
- Board meetings may take place by audio / video conference

Addressee of notice

- Notice must be given to all directors.



Board meetings

Length of notice

- No rule in the Companies Act – the M&A may provide for a notice period **BUT** this may be impractical if urgent matters arise
- In the absence of any notice period in the M&A, reasonable notice should be given

Form of notice

- No rule in the Companies Act – the M&A may prescribe the form of notice
- In the absence, notice through email / telephone should suffice
- Typically, an agenda is circulated with the notice



Board meetings

Documents to be circulated

- All documents pertaining to the business to be transacted at the meeting should be circulated within a reasonable time prior to the meeting

Quorum

- A quorum of directors may be present
- This is determined by the M&A; the Model Articles provide that the quorum is 2 directors



Board meetings

Voting

- No rule in the Companies Act; the M&A would typically state that voting is by simple majority
- Chairman may have a casting vote

Minutes

- Minutes must be taken for each Board meeting
- Signature of the Chairman is evidence that the proceedings took place in accordance with the minutes

Board Resolutions in Writing

- These are permitted if the M&A provide for this
- Resolution in writing would be valid and effective as if the same had been passed at a Board meeting duly convened and held
- Resolutions in writing must be signed by all directors entitled to receive notice of a board meeting



Reserved matters



Shareholder
reserved
matters



Director
reserved
matters



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