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Corporate Governance

Malta
Fenech Farrugia Fiott Legal

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Law and Practice

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Fenech Farrugia Fiott Legal operates from two principal bases, due to the particular nature of its organisation and spheres of expertise. The litigation team operates from the office in Valletta, which is the seat of the Law Courts of Malta. The rest of the team is located in offices that form part of a larger collaborative multidisciplinary professional services reality, originally developed by the firm in joint venture with local accountants, economists and other professionals to form the ARQ Group (www.arqgroup.com), a licensed corporate, trust and integrated advisory services group. Fenech Farrugia Fiott Legal acts as the legal advisory centre of expertise for the entire group. The firm's expertise covers the entire spectrum of corporate law, including corporate finance, organisation and governance. Other core areas of expertise include financial services law and regulation, asset finance, transport, maritime and aviation law. The firm is also well known for its solid foundations in the fields of real estate law and transactions, trusts and fiduciary obligations.

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1. Introduction

1.1 Forms of Corporate/Business Organisations

Maltese law is influenced by both major legal systems in Europe. Its foundation is the civil law as codified in the Napoleonic Code but it has also been heavily influenced and enriched by Anglo-Saxon inspiration, having been an English colony between 1800 and 1964, when it achieved independence. Malta joined the European Union as a full sovereign member in 2004, and Maltese law has consequently also drawn much influence and direct adaptation through EU Regulations and Directives since then.

Maltese principles of corporate governance reflect its cultural context. The legal system is generally organised following continental logic, with the Civil Code regulating a large number of socio-economic and commercial relationships, but particular economic sectors are regulated through direct statute, often with strong Anglo-Saxon inspiration.

Maltese company law and practice is primarily of Anglo-Saxon influence, and the logic for market organisation and development has generally tended to follow UK developments. The same is also true for Maltese principles of corporate governance, where practices have until recently followed UK rather than continental trends, albeit against a backdrop of increasing EU activity.

The Maltese economy has had a traditional preponderance of family-controlled private companies, but the backdrop is characterised by an increasing influx of foreign-controlled companies, together with a growing Malta Stock Exchange. Together with the progressive differentiation between capital control and corporate management, these developments have made the discussion of corporate governance principles extremely relevant in Maltese corporate circles.

The Second Schedule to the Maltese Civil Code provides a general backdrop for forms of organisation in general, contemplating legal organisations defined as a universality of persons who associate or a universality of things which are appropriated to achieve any lawful purpose. Various forms of legal organisations are contemplated, whether for public or private benefit, registered or unregistered, and whether granted separate legal personality or otherwise. It also provides for registered organisations lawfully establishing segregated cells to achieve particular purposes with particular assets. The law also provides for foundations as well as associations, and further contemplates the creation of formal trusts and trust relationships for any lawful purpose, including trading purposes under certain circumstances.

The principal forms of corporate/business organisations in Malta are in turn regulated by the Companies Act (Chapter 386 of the Laws of Malta), in terms of which a limited liability company is a commercial partnership having its capital divided into shares of a fixed amount and having the liability of its members limited to the amount, if any, unpaid on the shares respectively held by each of them.

Pursuant to article 209 of the Companies Act, a private company is one which by its memorandum and articles of association restricts the right to transfer its shares, limits the number of its members to 50 and prohibits any invitation to the public to subscribe for any shares or debenture of the company. A private company may also hold the status of private exempt company or a single member if certain conditions are met.

Public companies are defined as those which are not private companies. A public company may be listed on a stock exchange, including the Malta Stock Exchange.

Limited liability companies may also be investment companies, either with variable share capital (SICAV) or with fixed share capital (INVCO). In the context of the insurance industry, a protected cell company (PCC) may also be registered.

Public interest companies are defined as those companies which have an impact on the public in general and whose operations affect a substantial sector of society.

1.2 Sources of Corporate Governance Requirements

The Companies Act is the principal source of corporate governance requirements in Malta. The Malta Stock Exchange introduced the Code of Principles of Good Corporate Governance (the "Code") in 2001. Although the Code is relevant for all companies, it is only directly applicable to listed companies. As stated in its preamble, the Code's provisions are designed to enhance the legal, institutional and regulatory framework for good governance in the Maltese corporate sector. Investment companies and collective investment schemes have their own Corporate Governance Manual, and public interest companies also have separate guidelines issued by the Malta Financial Services Authority. Corporate governance in Malta is also significantly influenced by EU developments, as well as the OECD Principles of Corporate Governance.

A company's articles of association are a crucial element and cornerstone of its corporate governance rules and principles, as they prescribe the company's internal workings. However, it is worth noting that the promoters of a company do not need to prepare specific articles of association, as the law provides that the model articles of association in the First Schedule to the Companies Act will apply by default. The model articles can also complement any particular articles of association drawn up by the promoters, unless they are specifically excluded.

Article 3A of the Companies Act makes further reference to several EU Directives and Regulations, some of which are also directly relevant to corporate governance issues. The Capital Requirements Directive (2013/36/EU) and the Capital Requirements Regulation ((EU) 575/2013) deal with corporate governance and remuneration provisions for financial institutions, while the Commission Action Plan (COM(2012)740) on financing and sustainable growth identifies corporate governance as an important area to focus on.

1.3 Corporate Governance Requirements for Publicly Traded Companies

The Code is annexed to the Listing Rules issued by the Malta Financial Services Authority (the "Listing Rules") and is targeted at "*companies whose equity securities are admitted to listing on a Regulated Market but are not applicable to Collective Investment Schemes.*"

It is mandatory for listed companies to comply with the Code, on a 'comply or explain' basis. In the event that a company chooses not to comply with any provisions of the Code, it is required to give its shareholders a clear explanation illustrating how its actual practices are consistent with the Code and how this departure from the provisions contributes to good governance.

2. Corporate Governance Framework

2.1 Key Rules and Requirements

The law principally regulates the conduct and standards of behaviour required of directors, given their fiduciary role in the interests of the company. It further provides a regulatory backdrop for basic issues to be referred to the shareholders in general meetings, among other matters.

The Code also regulates the board of directors, including the roles of chairman and chief executive, the composition of the board, the responsibilities of the board, board meetings, information and professional development, the evaluation of the board's performance, committees, relations with shareholders and with the market, institutional shareholders, conflicts of interest and corporate social responsibility.

Jurisprudence and statutory action have tackled issues relating to corporate governance, such as the accountability of directors, as well as issues of transparency, disclosure of information and shareholders' accessibility to documents. Although Malta does not hold to the doctrine of judicial precedent, case law remains indicative of judicial trends.

Corporate social responsibility principles have also developed rapidly, and are generally recognised as representing the continued commitment by business entities to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families, together with the local community and society at large.

The Companies Act provides for various elements of disclosure and reporting, including a requirement for directors' reports to be delivered to the Registrar of Companies. Such reports for large undertakings of 500 employees or more should include a non-financial key performance indicator, which should include information relating to the development, performance, position and impact of its activity relating to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

The Code further lays down that directors should seek to adhere to accepted principles of corporate social responsibility in their day-to-day management practices of a company. Such practices should centre around the following:

- initiatives to increase investment in human capital, health and safety issues, managing change while adopting environmentally responsible practices relating to the management of natural resources used in the production process;
- acting as corporate citizens in the local community; and
- assessing the corporate social responsibility theme and keeping abreast of initiatives on a local and international basis.

2.2 Current Issues and Developments

The Maltese economy was traditionally dominated by family-controlled companies, but this is rapidly changing. Therefore, the possible extension to private companies of corporate governance rules initially designed for public companies has become an increasing topic of conversation in corporate board rooms in the jurisdiction.

A recent development, which is more pertinent to wider jurisdictional interests, is the establishment of a register of beneficial interests – and related reporting obligations to the Registrar of Companies. This development was brought about by the fourth EU Anti-Money Laundering Directive, and was brought into force in Malta by the Companies Act (Register of Beneficial Owners) Regulations, 2017.

Other developments as a result of case law have included issues pertinent to the fiduciary duties of officers and shareholders' rights of information. Board diversity issues, including gender diversity at board level, have become increasingly topical discussions.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The law provides that the business of a company is managed by the directors, who may exercise all relevant powers

of the company that are not required to be exercised by the company in a general meeting.

The law does not provide for any involvement by the shareholders in the management of a company. However, the members do have a role in a company's governance through the general meetings. In practice, this is principally done through the possibility of electing and removing directors.

Corporate governance therefore rests principally on the shoulders of the directors. However, it is important to note that, where the memorandum and articles of association – or the de facto management practices of any company – vest management powers in or on any person or body other than the directors, such person may be considered a "shadow director" at law, depending on the degree of control actually exercised.

In proceeding with their duties, the directors may or may not delegate executive management functions and roles to a management team. Furthermore, the board of directors often appoints committees to assist with the development of policies, executive oversight, risk management and other areas pertinent to the direction of the business.

Maltese law provides for a single tier structure for the board of directors. It is also worth noting that the law prescribes at least two directors for public companies, whereas a single director would suffice for private companies.

3.2 Types of Decisions Made by Governing Bodies

The board of directors bears responsibility for all decision-making powers of the company other than those reserved for the shareholders in a general meeting by law or by the memorandum and articles of association.

The decisions typically taken by the shareholders in a general meeting include alterations to the memorandum and articles of association, the appointment and removal of directors, the amalgamation and reconstruction of the company, the dissolution of the company, increasing the authorised capital of the company, approval of annual financial statements, and the appointment of financial auditors.

3.3 Decision-making Processes

At the board of directors' level, decisions are normally taken through resolution. The articles of association would generally state that questions arising during a meeting should be decided by majority vote; in the case of a tie, the chairman would normally, but not necessarily, have a casting vote. The Companies Act provides that minutes of all board meetings must be kept in appropriate minute books, for proper recording purposes.

Alternatively, a resolution in writing, signed by all directors, is also valid and effective as if it had been passed at a meeting of the directors duly convened and held.

The Companies Act provides general rules concerning meetings of shareholders and resolutions, but also allows wide latitude for the articles of association to provide otherwise. The Companies Act distinguishes between ordinary and extraordinary resolutions on the basis of the percentage of votes required for the resolution to be considered carried. This allows for the categorisation of decision-taking in terms of strategic or structural importance, which would in turn allow for the leadership of the company to enjoy more certainty of direction.

Shareholders of a private company may also exercise their powers through unanimous written resolution of all shareholders without the requirement of a meeting, provided that the decision does not relate to the removal of a director or auditor.

4. Directors and Officers

4.1 Board Structure

The directors of a company are referred to collectively in the Companies Act as having clear duties to act in the best interests of the company. The Companies Act does not refer to the board of directors, but to the directors in general, and to the office of director, in terms of the responsibilities shouldered by persons accepting such office.

The Companies Act provides a general description for the office of "director", not a technical definition, referring to the term as including "*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 direction of the company as those carried out by a director.*" The term therefore encompasses all persons who fulfil such a role as a matter of fact, irrespective of whether they are formally described as directors or otherwise.

Maltese boards typically include a chairman as well as the company secretary. The role of chairman is not specifically contemplated in the Companies Act but is described in the Code as the person generally having responsibility to lead the board, set its agenda, and ensure that the directors receive precise, timely and objective information. The chairman is also normally responsible for ensuring effective communication with shareholders, and for encouraging all board members to engage actively in discussion of complex and contentious issues. The Code draws a clear distinction between the roles of chairman and chief executive officer, stating that there should be a clear division between the running of the board and the executive responsibility for running the company's business.

The position of company secretary, on the other hand, is specifically imposed by the Companies Act as a company's "administrative officer", as opposed to anything directly connected with carrying on the company's business. Jurists have occasionally questioned the breadth of actual responsibility shouldered by the company secretary, particularly since article 150 of the Companies Act provides that anything required to be done by a company under any provision of the Act "*shall be deemed also to be required to be done by the officers of the company.*" Having stated this, however, it is generally believed that the intention of the legislator was not so broad as to make the responsibilities of company secretary and director indistinguishable. The responsibility of the company secretary is therefore seen as possibly limited to matters of a more administrative nature.

There are specific functions imposed by statute on the company secretary, and others which are more customary in nature. The principal statutory duties relate to the proper keeping of registers and minute books, and to the filing of documentation with the Registrar of Companies where required. Other specific functions and responsibilities relate to the proper handling of meetings of the board of directors, as well as general meetings of the company.

The law does not distinguish between executive and non-executive directors, but the Code lays down that the board of a listed company should be composed of executive and non-executive directors, including independent non-executives.

4.2 Roles of Board Members

As already indicated, the law deals with the role of directors in a collective manner in terms of their management role, but also specifies general norms of behaviour, given the fiduciary nature of any director's obligations to the company. Thus, each director is bound to act honestly and in good faith in the best interests of the company, exercising such skill and knowledge as may be expected of a person accepting such a position, and avoiding conflicts of interest. The directors are furthermore collectively responsible for the general governance of the company and its proper administration and management, as well as the general supervision of its affairs.

The model articles of association then specify rules for the holding of meetings, decision taking and the election of a chairman, as well as the delegation of any executive powers to a managing director or any directors holding any other executive office. The directors have the power to revoke any such delegated authority originally conferred. The directors may also appoint committees selected from among themselves for the purposes of delegating any of their powers.

The Code considers it important to have non-executive directors appointed, including independent non-executive directors, in order to avoid situations where an individual or small group dominates the board's decision making. A non-executive director is described as one who is not engaged in the daily management of the company.

The Code envisages non-executive directors as being in a position to exercise independent and impartial judgment. They should also constructively challenge and help to develop the application of the strategy and policy of a company. A non-executive director should furthermore effectively monitor the reporting of performance, which aims at better transparency and governance of the company, besides scrutinising the performance of management. Finally, a non-executive director should be satisfied with the financial information presented, and ensure that financial controls and risk management policies are in place and properly implemented.

4.3 Board Composition Requirements/Recommendations

The Code suggests that the board should not be so large as to prove cumbersome, and should be made up of an adequate number of directors appropriate for the requirements and nature of the business carried out by the company. A balance of skills, know-how and experience should be sought to be created.

Directors are required to provide good leadership, integrity and judgement in guiding the company to reach its aims and goals. In order to achieve this, directors should develop the necessary skills and hold relevant experience to make effective decisions whilst discharging their duties.

4.4 Appointment and Removal of Directors/Officers

The memorandum of association of a company specifies the identity of the directors of the company in office, while the articles of association will normally provide the mechanics of appointment and removal, the number of directors to be elected, and similar details.

The law does not provide any specific qualifications (academic or otherwise) for directors, other than making reference to general standards for persons accepting fiduciary obligations.

Any person who is at least 18 years of age can be appointed director. Moreover, a director can continue to hold his position after retirement. Additionally, there are no restrictions on the nationality or habitual residence of the directors.

On the other hand, companies that are active in specific sectors, such as the financial services sector or other specialised sectors that are subject to specific regulation and licensing, are required to adopt specific "fit and proper" criteria when putting forward candidates for appointment as director. Furthermore, such laws often subject any nomination of a

director to approval from the relevant sector-specific authority concerned.

The Companies Act also provides for those elements that would disqualify any individual from becoming or remaining an officer. This is a reference to persons who are (i) interdicted, incapacitated or undischarged bankrupts; (ii) convicted in relation to crimes affecting public trust, theft, fraud or knowingly receiving property obtained by theft or fraud; or (iii) unemancipated minors.

Appointment
The memorandum of association of the company identifies the first directors of the company. The Companies Act stipulates that the name and residence details of the directors should be specified therein. In the case of a director that is itself a corporation, the name of the entity as well as the registered address should be included.

Succeeding directors are then appointed by ordinary resolution of the company in a general meeting, and all changes must be duly filed with the Registrar of Companies through the appropriate form. In the case of public companies, the Companies Act stipulates that a director of a public company must sign the memorandum indicating his/her consent to act as such. In the case of succeeding directors, the director has to sign and deliver his consent in writing to the Registrar for registration.

Removal/Vacancy
The office of director may become vacant for several reasons, such as expiration of the term of office, death, resignation, disqualification or removal. The memorandum and articles of association may authorise the appointment of a director for any specified period of time. There is no limit to holding office, as long as the appointment is made pursuant to the applicable rules. A director may even hold office for life. A vacancy on the board of directors is automatically created by the death of any incumbent.

A director is generally free to resign from office at any time. This is normally done through notice in writing delivered to the chairman or company secretary. Alternatively, a director may tender his/her resignation during a board or general meeting – in which case, the resignation would be recorded in the minutes of the relevant meeting.

A director may become disqualified from continuing to hold office in terms of law and/or pursuant to the memorandum or articles of association. In such circumstance, such office is automatically vacated, and no act of resignation is required.

Furthermore, the company may seek to remove a director from office by resolution taken at a general meeting of the company and passed by the members having the right to attend and vote thereat, and holding in aggregate at least 50% of the voting rights attached to the shares represented and entitling them to vote at a general meeting. The Companies Act makes it clear that removal by resolution shall remain effective notwithstanding any contrary provision in the memorandum and articles of association or any agreement with the particular director concerned. However, any such intended resolution must be brought to the prior notice of the individual concerned. Once a director is removed by the general meeting, a vacancy is created. Should the vacancy not be filled at the same meeting, it could be filled as a casual vacancy. Furthermore, the removal of the director in this manner does not deprive him or her of the right to compensation or damages that may be payable to him or her in terms of the general principles of law.

In the event of any change in the composition of the board of directors, including any change of company secretary, the company must notify the Registrar for registration of such change by means of the appropriate form, which must be filed within 14 days of the change and must specify the date of the change, together with the required details of the newly appointed officer. This form is usually signed by the company secretary or any one of the directors.

4.5 Independence of Directors and Conflicts of Interest

The rationale behind the drafting of the Code is ensuring that there is appropriate leadership in terms of oversight of the executive management of the business concerned. It emphasises the importance of having a clear division of responsibilities between the executive responsibility for running the company's business on the one hand, and the board on the other. Where it is not possible for the chairman of a listed company to be different from the chief executive officer, the Code enjoins the company to provide an explanation to the market and to its shareholders through a company announcement explaining the decision to combine the two roles. The Code also provides that a chief executive should not become chairman of the relevant company, other than by way of exception, and only after consulting major shareholders in advance and providing reasons for such a decision to the shareholders in the directors' annual report.

The Code furthermore provides for the appointment of non-executive directors, recommending that at least one third of the board is composed of non-executives, with the majority of these being independent. Non-executive directors are not engaged in the day-to-day management of the company and are expected to have an important role in overseeing executive directors, dealing with situations involving conflicts of interest and generally bringing "fresh perspectives" and a more objective contribution to support or constructively challenge the management team. They are seen as generally being in a position to bring independent judgement to bear on the various issues brought before the company.

As such, non-executive directors should be free from relationships that could materially interfere with the exercise of their independent and impartial judgement. They are considered independent where there is no conflict of interest whatsoever.

The Companies Act buttresses the provisions of the Code in prohibiting conflicts of interest, including self-dealing. Directors may not enter into transactions in competition with the company itself, unless there is appropriate disclosure and approvals received. Nor can a director accept office with two companies that are in competition with each other. In such circumstances, the aggrieved company has the option of either taking the necessary action for damages inclusive of interest against the relevant director or demanding payment of any profits made.

Article 143 (1) of the Companies Act stipulates that a director shall declare any personal interest in any particular transaction. The company may choose to proceed with the transaction itself. The Companies Act captures the essence of this rule in a three-fold manner, prohibiting the director from:

- making secret or personal profits from his position without prior consent of the company;
- making personal gain through the use of confidential company information; and
- using property, information or opportunity of the company for their own personal benefit.

4.6 Legal Duties of Directors/Officers

Directors are considered as owing fiduciary obligations to the company they serve. Article 1124A of the Civil Code sets out the general rules underlying all fiduciary obligations, but these are further supplemented by the rules laid down in the Companies Act.

The Civil Code provides for general duties such as that of honesty and utmost good faith for persons in a fiduciary relationship, together with the avoidance of conflicts of interest. The Companies Act further provides that directors are bound to perform their duties with the level of care and skill that would be exercised by a reasonably diligent person having the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions.

Apart from the abovementioned duties, directors also shoulder various administrative responsibilities for the company, mainly revolving around the proper handling of registers, such as the register of members and the register of debentures, as well as appropriate minute keeping. Other administrative tasks relate to the filing of returns and documents with the Registrar of Companies. For instance, a director must file any changes that are made to the memorandum and articles of association with the Registrar, as well as any change in the issued share capital of a company.

4.7 Responsibility/Accountability of Directors

The general principle under Maltese law is that directors owe their primary duties to the company as opposed to the shareholders. This was also established in case law, notably in Sant Fournier v Philip Attard Montaldo (First Hall Civil Court, 2001). Directors are considered to be fiduciaries as well as mandatories of the company, which has a distinct and separate juridical personality from that of its shareholders. As its duly authorised officers, the directors exercise all powers of the company.

Having stated the foregoing, the directors also owe duties to the shareholders in important ways. Under the Civil Code, fiduciary obligations are generally owed by any person who, as a matter of fact, whether in contract or even through assumption of office, "*owes a duty to protect the interests of another person.*" It is clear that the primary obligations owed are to the company itself, but it is also arguable that a general standard of care is owed to the shareholders, whose enterprise has been entrusted to the general direction of the directors and the company's management.

The Companies Act also provides specific remedies to shareholders in situations where any director acts in an unfairly prejudicial manner. In terms of article 402 of the Companies Act, any member of a company can make an application to the court for appropriate orders where the company or its management have acted, or are likely to act, in a manner that is "*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.*" Where the court sees that such a demand is well founded, and considers it equitable to do so, the court can make a wide range of orders in terms of the management of the company going forward, including ordering transfers of shares, as well as the dissolution of the company. Crucially, the court can also order the payment of compensation by the person responsible for whatever oppressive action or omission to the oppressed member or members.

The Companies Act also provides for the possibility for shareholders (holding no less than 10% of the share capital) of a company, or the company itself, to request investigations by the Registrar of Companies into the manner in which any company is being managed, provided that they provide appropriate evidence of abuse. In such circumstances, the Registrar can appoint inspectors with wide powers of intervention, and can also resort to the same action provided to the members pursuant to article 402 of the Companies Act.

4.8 Breach of Directors' Duties

There are several avenues of action and remedy available to wronged parties as a result of abusive action by the directors of a company.

The general principle under the Companies Act is that the personal liability of directors resulting in a breach of duty is joint and several.

If a director breaches any of his duties, both the company itself and any wronged member may, in addition to any other remedy available, take action for damages and interest against the director or directors in question. The court also has other powers that can be imposed, including a change of management personnel, a change in shareholding or the dissolution of the company.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

The remedies against abuse of office committed by directors and other officers are wide.

The Companies Act clearly stipulates that any provision – whether found within the memorandum and articles of association of the company or within any agreement made between the director and the company – to exempt or indemnify a director against liability for negligence, default or a breach of duty is void. On the other hand, a company may purchase and maintain insurance cover against certain liabilities and losses also for its officers.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The model articles contained in the First Schedule to the Companies Act recognise the directors' right to remuneration as approved during the general meeting by ordinary resolution. Apart from remuneration, directors are typically also paid for any travel expenses incurred by them for business purposes.

In the case of listed entities, the Code states that a remuneration committee must be established to develop a remuneration policy for directors and senior executives of the company. The principal role of the committee is to formulate an attractive package in order to attract, retain and motivate directors and senior executives.

4.11 Disclosure of Payments to Directors/Officers

The model articles included in the First Schedule to the Companies Act provide that directors' remuneration is actually determined by the company in the general meeting. The Code provides for a "Remuneration Statement", which should disclose detailed information on the current policy, including various analyses, and disclose any intended changes for the coming year.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A company has a legal personality that is completely distinct from that of its members, and is therefore a completely independent subject of rights and obligations at law. Any ongoing liability of a shareholder for any losses incurred by the company is limited to any portion of share capital held to his name that he has yet to deposit. Incorporation, therefore, introduces what is commonly described as a 'corporate veil', which in effect renders shareholders immune from action by third parties, including the corporation itself, to cover any losses of the corporation. Such a veil can be lifted in very limited circumstances, such as instances where fraudulent or wrongful trading can be established in the context of insolvency.

The Code provides that the board shall account to shareholders fully, utilising general meetings to regularly communicate with shareholders. Furthermore, the board must endeavour to protect and enhance the interests of both the company and the shareholders, present and future. On the other hand, the Code invites shareholders to appreciate the significance of participation in general meetings of the company, and particularly in the election of directors. In particular, shareholders should "*continue to hold directors to account for their actions, their stewardship of the company's assets and the performance of the company.*"

The Companies Act defines a "shareholder" as a person entered in the register of members of a company. Following incorporation, the relationship between a shareholder and the company is principally circumscribed by the terms of the memorandum and articles of association of the company, apart from specific rights conferred by law. Any further rights to be asserted by the shareholder are not against the company itself, but rather against the directors or officers, to the extent that a remedy under article 402 or in terms of any breach of fiduciary obligations towards the shareholder can be established (see **4.7 Responsibility/Accountability of Directors**, above).

5.2 Role of Shareholders in Company Management

The Companies Act makes it amply clear that "*the business of a company shall be managed by the directors.*" As already pointed out, this does not mean that the shareholders in a general meeting do not have any interest or say in the governance of the company. The key distinction to be made is therefore between the management of the business of the company, and the company's proper governance. In terms of governance, it is the shareholders who appoint the directors, and it is the shareholders who will have to approve various matters, including financial matters such as increasing the company's share capital and approval of annual accounts.

Being contractual in nature, the memorandum and articles of association can provide for various variations of the foregoing general principle. The factual situation, irrespective of the manner of drafting of the constitutive documents, however, remains key. In smaller companies, the influence of the shareholders naturally tends to be greater than in larger companies. The extent to which individual shareholders or groups of shareholders are involved in the management of the company will in fact depend largely on whether or not they are acting as directors, or whether or not the directors have delegated or otherwise entrusted part of their management function to them. In all cases, factual considerations will trump formal documentation, given the "shadow director" concept followed by the Companies Act.

In listed companies, the shareholders will have little opportunity to participate in the management of the company. By way of counter-balance, the Listing Rules include a number of disclosure requirements to shareholders. Such disclosure duties are not necessarily for the benefit of the shareholders but are in the interest of the market as a whole, since listed companies have dispersed share ownership. In the Corporate Governance Guidelines for Public Interest Companies issued by the Malta Financial Services Authority, the board is also required to protect and enhance the interest of both the company and its shareholders, present and future, and requires the board to make certain information available to shareholders for inspection, in order to ensure participation in the general meetings. Shareholders are directly encouraged to participate in general meetings, particularly in the election or appointment of directors, and to hold them accountable for their actions.

5.3 Shareholder Meetings

Article 128 of the Companies Act provides that every company registered in Malta must hold an annual general meeting, in addition to any other meetings. The first annual general meeting must be held within 18 months of registration. Other shareholder meetings of the company are referred to as extraordinary general meetings.

The memorandum and articles of association of a company will provide for the management of business to be considered at an annual general meeting. Shareholders are entitled to attend and vote at a meeting of the company or at a meeting of any class of shareholders, personally or via a proxy. The appointment of a proxy must normally be in writing.

A general meeting of the company must be called with at least 14 days' notice in writing. The notice must exclude the day on which it is served, and specify the place, day and hour of the meeting. A meeting may be called with shorter notice if agreed by all the members entitled to vote and attend. Article 131 of the Companies Act provides that, unless the articles of association of a company provide otherwise, "*two members personally present shall be a quorum.*" The model articles provided for in the First Schedule to the Companies Act provide that "a member or members" representing not less than one tenth in aggregate of the paid-up share capital of the company having the right to attend and vote shall be a quorum.

If a quorum is not reached, the meeting shall be reconvened to a new time and place as the directors may determine and if at the adjourned meeting the quorum is not present within half an hour from the time appointed for the meeting, then the member or members present shall be a quorum.

At general meetings, shareholders manifest their wishes by voting for or against the proposed resolutions and, as a rule, the will of the majority of those members having shares with voting rights will prevail. This principle applies with certain safeguards at law, however, intended to protect the rights of minority shareholders, as will be seen in **5.4 Shareholder Claims**, below. Shareholders vote on matters concerning the appointment of directors, the distribution of dividends, the approval of the accounts and balance sheet, the directors' report and auditors' report, and the appointment of auditors.

For listed companies, the Listing Rules include requirements regulating the method of notifying shareholders, the contents of a notice of the general meeting, the notice period, participation and voting, proxies and the publication of certain information prior to the general meeting. The Listing Rules also give the right to a shareholder holding not less than 5% of the voting issued share capital to request that items be included on the agenda of a general meeting (accompanied by a justification or drafted resolution to be adopted), and to table draft resolutions for items on the agenda. In the Corporate Governance Guidelines for Public Interest Companies, the requirements for notice are less prescriptive and more generic, appealing to principles of equality and fair treatment between shareholders.

5.4 Shareholder Claims

Shareholders have certain rights and remedies available to them as individual members of the company. A shareholder may sue a director or directors under article 402 of the Companies Act, where the affairs of the company have been or are likely to be conducted in a manner that is oppressive, unfairly discriminatory or unfairly prejudicial against a member or members, or against the interests of the members as a whole.

A shareholder also has the right to make an application in court for the following:

- to appoint a director, where the number of directors falls below the minimum required by law;
- to appoint auditors for the company;
- to wind-up a company where certain conditions are met;

- to appoint a liquidator when a liquidator is not appointed in the manner provided by law, and summon creditors' meetings; and
- to remove a liquidator when there are sufficient grounds to warrant such removal.

The Companies Act grants protection to members who as a group qualify as representing "qualified minority rights" expressed in terms of a percentage of the issued share capital or as a minimum number of members. The Companies Act provides that a qualified minority of the shareholders may:

- require the directors to convene an extraordinary general meeting;
- demand a poll;
- request the Registrar to appoint inspectors to investigate and report on the affairs of a company; and
- request the Registrar to investigate and report on the membership of a company for the purpose of determining the true persons who are or have been financially interested in the success or failure of the company or able to control or materially influence its policy.

Where a proposed change in class rights is unfairly prejudicial, article 116 of the Companies Act grants the holders of not less than 15% of the issued shares of any class the right to request a court order that such change does not take effect.

The memorandum and articles of association may also confer rights on individual members and qualified minorities. Shareholders may also avail themselves of certain general provisions in the Companies Act that give rights to an interested person, and also to the protection granted by virtue of the general principles of law, such as instituting judicial proceedings in case of fraud.

5.5 Disclosure by Shareholders in Publicly Traded Companies

The Listing Rules require a shareholder who acquires or disposes of shares to which voting rights are attached to notify the issuing company and the Listing Authority (MFSA) of the proportion of voting rights held by him as a result of the acquisition or disposal where that proportion reaches, exceeds or falls below certain thresholds established therein.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

A company is dutybound to file a copy of the company's annual accounts, a copy of the auditors' report on the accounts and a copy of the directors' report in respect of each accounting period with the Registrar of Companies, within 42 days of the end of the period for the laying of annual accounts.

The company is also dutybound to file an annual return, which should be in the form set out in the Seventh Schedule to the Companies Act and should include a summary of the share capital, divided into nominal and issued shares in each class and the number and percentage which is paid up, the total number of shares of each class forfeited and the total amount paid. The annual return should also include a list of present members and members who have held shares or stock in the company since the date of the previous annual return, and details of the directors and the company secretary of the company as at the date of the annual return.

The Listing Rules include the requirements for financial reporting of listed companies. The annual financial report of listed companies must include the annual financial statements together with the directors' report and auditors' report, a statement of responsibility drawn up by the directors on the financial statements and a fair review of the performance of the business, a report by the directors and a report by the auditors on compliance with the Code, information on material contracts and the name of the company secretary. The Listing Rules also require listed companies to make a half-yearly financial report, which includes a condensed set of financial statements, an interim directors' report, statements by directors, the auditors' report or, where the report has not been audited, a statement by the listed company that the financial report has not been audited.

6.2 Disclosure of Corporate Governance Arrangements

There are no requirements for the publication of any corporate governance arrangements for private and public companies.

On the other hand, listed companies must include a corporate governance statement in their annual financial report. The statement must contain various details, including a reference to the corporate governance code to which it is subject, all relevant information about the corporate governance practices applied, any departure from the application of any provision of a corporate governance code, and a description of the internal control and risk management systems of the company in relation to the financial reporting process. Other details include information required to be disclosed in terms of EU Directive 2004/25/EC on takeover bids, the manner in which a general meeting is conducted, shareholders' rights and how they can be exercised, the composition and operation of the board of directors, and details on the audit committee and any other committee established by the board.

For a company that has an average of 500 employees during the relevant financial year, the Code requires the corporate governance statement to include a description of the diversity policy applied in relation to the board of directors and management and supervisory bodies of the company. The

auditors shall furthermore include a report on the corporate governance statement in the annual financial report.

6.3 Companies Registry Filings

Every company is required to make certain filings with the Registrar of Companies, as listed in various provisions of the Companies Act. The filings are publicly available at the Malta Business Registry, against a fee.

7. Audit, Risk and Internal Controls

7.1 External Auditors

A company must appoint an auditor or joint auditors and prepare audited financial statements and an auditor's report for every financial year. The auditor is appointed at each general meeting where the annual audited accounts are laid, and holds office from the conclusion of that meeting until the conclusion of the next general meeting at which accounts are presented. The first auditors are appointed by the directors before the first general meeting of the company at which the annual accounts are presented, and they hold office until the conclusion of that meeting. Subsequently, the auditors are appointed by ordinary resolution adopted by the shareholders at the annual general meeting. If directors do not exercise their right, then the company may appoint the auditor at the general meeting. If no auditor is appointed, the court can order the Registrar to appoint someone to fill the vacancy on application from any of the directors or any member of the company. In public interest entities, the appointment of auditors should not exceed the maximum periods as established by law.

A company may remove an auditor from office by a resolution taken at a general meeting and passed by a member or members holding more than 50% voting rights. If the resolution is passed, then the company must inform the Registrar within 14 days for registration. An auditor may also resign from office by depositing a notice in writing at the company's registered office. In such case, the company must likewise notify the Registrar within 14 days from receipt of such notice of resignation.

7.2 Management Risk and Internal Controls

There are no requirements or guidelines in the law relating to management risks and internal controls in a private or public company, but there are fiduciary obligations emanating at law when directors are managing the affairs of the company, making directors directly accountable to the shareholders and the company.

With listed companies, the corporate governance statement must include a description of the internal control and risk management systems of the listed company in relation to the financial reporting process.

A further source of risk management and internal control is the audit committee, which can fulfil a vital supervisory function over the board of directors. The Listing Rules provide that the committee should be composed solely of non-executive directors and have at least three members; the majority of such members have to be independent of the listed company. One member of the audit committee needs to be competent in accounting and/or auditing. The primary objective of the audit committee is to assist the board of directors in the company's decision-making process and ensure qualitative reporting, in particular when managing the relationship between the company and its auditors. The members of the audit committee are required to have oversight of the effectiveness of the company's internal quality control and risk management systems, and of monitoring material transactions, including related-party transactions.

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