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The Mayflower, the Rapsody and other recent company law cases

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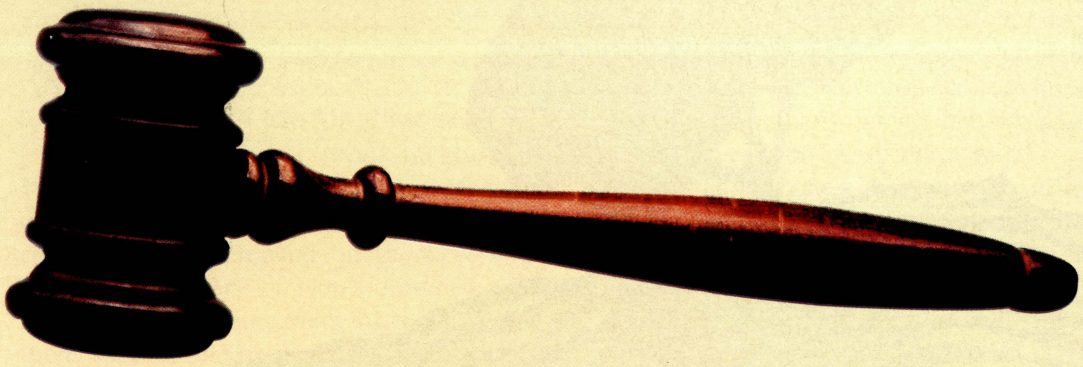

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Company law means much more than the Companies Act of 1995. Other laws contribute important additions to the subject. Significant examples are the Malta Stock Exchange Act and the Investments Services Act. Another important part is also played by the type of advice that lawyers give to their clients and how these laws are generally interpreted and applied in practice. Court decisions are another potentially significant source of guidance and interpretation. They apply legal principles to the facts presented before the court by the parties in dispute.

It is not always easy to update oneself on judgements and decisions taken by local courts and other relevant tribunals. They are not always easily available. The purpose of this article is to highlight selected recent decisions of Maltese courts which are directly related to company law. These decisions help to throw some light on corners where the law in its traditionally general application cannot easily reach. Actual cases serve to flesh out the often bare rules of corporate legislation. A studied well-prepared judgement may often prove as precious and instructive as the law itself.

This Article shall outline four recent court decisions which provide us with the benefit of novel interpretations and give guidance on how some basic company law principles should be applied in practice. All these decisions are relevant to those whose work brings them into contact with persons who own or manage companies.

Two cases disclose the surprising extent to which company directors often fail to distinguish between corporate and personal property and obligations. One decision relates to difficulties encountered in the appointment of directors in a particular situation. Indeed, an ever-growing concern of modern company law relates to director performance and behaviour, which form a part of a broader area of interest often referred to collectively as Corporate Governance. Corporate governance is slowly becoming rather over-used and now risks to mean only what the user wants it to mean. Indeed, it has no precise legal meaning, and in fact is often used in different circumstances. Nonetheless, it is a useful concept which must, at the very least, be taken to require company directors to act properly, competently and in good faith in the best interests of the company within the confines of their legitimate powers under the law. Some of these rules may be found in legislation, particularly the Companies Act of 1995. However, for the concrete application of these rules to particular circumstances, one may have to seek out court judgements and similar decisions.

(1) Migdal Insurance co. Ltd. Et v.

Abrador S.A. and Konda Assets S.A. et decided by the Civil Court on the 18th May 2001 (W/S 2106/1998)

Summary: Resuscitation of a company which has been struck off the Register; court establishes fraudulent intent behind the voluntary liquidation and consequential winding-up of a company when arbitration proceedings were pending against it; court orders it placed back on the Register exclusively for the purpose of the arbitration proceedings.

It all started with the Mayflower.

Readers would surely recall the milestone event in 1620, when the good ship Mayflower crossed the Atlantic to land the first pilgrim-colonizers from England on the new, largely uncharted territory of North America. They had a truly tough time there initially and half of them died of sickness within a year of their arrival. But the remaining passengers survived, and the rest, as the cliché' goes, is history.

Our own local Mayflower case may not enjoy such historical significance, but it may be considered a milestone in the development of local company law. The decision tackled for the first time the possibility of company survival despite having been struck off the Register of Companies. A notion often dismissed as inconceivable and fraught with risks.

In the Maltese Mayflower case (full name - Mayflower Property Company Ltd. v. Registrar of Companies decided by the Civil Court in on the 22nd January 1999), the Court had allowed the shareholders of a company to rectify a mistake in the scheme of distribution after the company had already been struck off. There, a piece of immovable property (an airspace) that had been inadvertently omitted and had consequently not been assigned to anyone. The shareholders were allowed to reverse the procedures in order to permit the correction required. The court had then studiously avoided using the term "revival" of the company or similar, but the effect of the remedy was the same.

The Mayflower decision has now been confirmed and indeed developed further in the more recent Rapsody decision.

The Rapsody case relates to a Maltese company which owned a vessel. In the course of a particular voyage, the vessel sunk losing its cargo. The cargo owners sued the owners of the vessel and opened arbitration proceedings in terms of the charter-party agreement between them. The shareholders of the company owning the vessel dissolved the company. The company was then wound-up and eventually its name was struck off the Register of Companies. The cargo-owners asked the Maltese court to order the annulment of the dissolution, the winding-up and the striking off in order to allow the arbitration to continue its course.

As this case involved a private shipping company, the operative law was not the Companies Act but the Commercial Partnerships Ordinance. In neither law, however, is there a legal provision governing the possibility of reviving a company which has already been wound-up and struck off the Register.

In the Rapsody case, the court identified bad faith on the part of the shareholders of the company. Quoting the old axiom fraus omnia corrumpit, the court made it clear that no person should be allowed to take an advantage through his own bad faith.

In its decision, the court ordered – limitedly in the interests of plaintiff - the cancellation of all the procedures that had been adopted for dissolving the company, for winding up its affairs and for striking it off the Register. It ordered the revival of the company, but only to the extent that was necessary for removing the harm done to plaintiff and for allowing plaintiff to resume the arbitration proceedings and to eventually execute the award, should it be favourable to him. All other parties were to remain unaffected by the remedy given to plaintiff, meaning that for the rest of the world Rapsody Shipping Limited was and remained struck off and was no longer in existence.

A few questions arise out of this important decision.

(a) Is it conceptually feasible for a company to be at the same time in a state of relative existence and relative non-existence?

(b) A company is created by the free will of its shareholders. The law recognizes that the free will of the shareholders can put an end to a company and dissolve it. Is it proper for the courts to ignore and reverse a decision taken by the free will of a company's shareholders?

(c) Following dissolution, a company does not cease to exist but remains a living entity represented by its liquidator during the winding-up operation. The liquidator could represent the company in the arbitration proceedings. It is arguable that the court could have limited its reversal to the winding up stage and stop short of cancelling also the shareholders' resolution to dissolve.

(d) Should a court be allowed to force share-

holders to retain a company in existence against their will, or to force persons to act as directors of a company against their will?

(This case involved a Maltese company by the name of Rapsody Shipping Limited and its vessel which sank bore the unromantic name of "Grape One". The case was instituted against the shareholders of the company which were two foreign companies and against the company itself. Strangely it was not instituted also against the liquidator.

The owners of the vessel are lodging an appeal from this decision.)

(2) Autorentals v B. decided by the Court of Appeal on the 14th November 2000 (W/S no. 344/95 JSP)

SUMMARY: Corporate property employed to resolve a personal problem between a director and his wife; highlights the anomalous results that may flow when personal issues are mixed with corporate property. The decision itself gives rise to certain doubts.

H (a businessman) and W (his wife) had concluded a contract of personal separation in terms of the Maltese civil code. Under this contract, H's company (plaintiff) granted a life usufruct over a flat to W on condition that she

did not re-marry or co-habit with another man in the flat. The usufruct allowed the enjoyment of the property to the beneficiary (the usufructuary) during her lifetime and did not entail the payment of any consideration.

Plaintiff company requested the Court to dissolve the usufruct and to evict W on the ground that she had violated the cohabitation prohibition. Defendant pleaded that the conditions attached to the usufruct were invalid as they were not of a commercial nature and were consequently ultra vires the company. The Civil Court held that the company had the necessary powers under the law to stipulate these types of conditions remarking that it could not be excluded that the usufruct served the interests of the company.

The Court of Appeal agreed with the Civil Court that a company had the necessary corporate capacity to enter into any act conducive to its business. Had this not been the case, the consequences would have been more far-reaching and the entire grant of the usufruct would have been declared invalid. The Court of Appeal remarked that defendant was hardly the legitimate person to attack the validity of the agreement once she had signed and benefitted from the contract. If anything, it was only the company's shareholders who may conceivably have had an interest to attack the grant of the usufruct.

It is interesting to note that

(a) while the husband was not personally a party to the proceedings, he represented plaintiff company as its director and judicial representative;

(b) the court did not explain how a gratuitous grant of a usufruct to a director's wife upon a legal separation from her husband could be considered to be in the company's interest.

(3) Rustica Limited v. N. Gatt decided by the Court of Appeal on the 27th October 2000 (App. 60B/96)

SUMMARY: A company's separate personality; Court strikes down a clumsy attempt to bypass the Salomon rule for the sake of opportunistic convenience

Defendant had rented a store from plaintiff company for his business. The lease agreement

prohibited any form of sub-letting to third parties. He later re-organised his business affairs and started operating as a company which took over the lease. The premises also served as the company's registered office. Plaintiff claimed that this amounted to a breach of the lease agreement prohibition. Defendant originally claimed that he was wrongly suited as he was no longer the tenant. However, he eventually admitted ceding the lease to his company but argued that as he was effectively the owner and operator of the business there had been in practice no transfer of the lease. The court rejected defendant's argument and ordered him to evict the premises.

Facts of case may be indicative of a degree of confusion between private and corporate property in the minds and conduct of directors and shareholders.

(4) C. Testaferrata Moroni Viani et v. Testaferrata Moroni Viani (Holdings) Limited et decided provisionally by the Civil Court on the 30th August 1999 (App. No. 1711/99 GC).

SUMMARY: Section 402 f the Companies Act; inability to elect directors; majority shareholders request remedy against unfair prejudice or oppression; court appoints a board of directors with independent chairman

In this case, a company's Articles of Association established that all the directors were to serve until the next annual general meeting during which election of directors would then be held. To be elected directors, directors needed to gain seventy-five per cent of the votes. This vote was never reached and a dangerous stalemate arose. The annual general meeting was never closed and the outgoing directors decided to continue in office.

The majority shareholders with sixty per cent commenced an action under section 402 of the Companies Act (the unfair prejudice remedy section) requesting the court to confirm the present board of directors.

The defendants who were the minority shareholders pleaded that they could not be accused of oppressing the majority, and that therefore section 402 did not extend to the present circumstances. They were however prepared to accept a board appointed by the court to replace the current board in which they had no confidence.

The court held that it was vital for the company to have a proper board of directors, and in the circumstances it was just and equitable that the court should proceed to appoint a properly constituted board in the interests of all the company's members who should be represented in equal measure. The court appointed a neutral and experienced chairman together with two directors representing each of the two sides in the dispute. The chairman was to safeguard the interests of all the shareholders. The Court decreed that the Board was to meet not less than once a month and that no meeting could be held without the presence of the chairman. Where a director is absent from a meeting, the chairman would also have a casting vote. The chairman's remuneration was to be determined by a unanimous Board decision; in the event that no agreement is reached, the issue was to be referred to the court.

Finally, the court decided that for the time being its orders were to remain of a provisional nature subject to review. After four months, the chairman was required to report to the court on the performance of the newly composed board.

(Eventually, some weeks following this court order, the shareholders reached an amicable agreement between them, which included the confirmation, by unanimous agreement between all the shareholders, of the composition of the board of directors as had been ordered by the civil court. On the basis of this settlement, the court proceedings were withdrawn.)