

THE FIDUCIARY DUTY OF COMPANY  
DIRECTORS IN MALTA

by

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## **Abstract**

This thesis examines the development of the fiduciary duty under the Maltese corporate law as an example of legal transplantation through the Maltese statutory and judicial approach.

Based on the review of the legal transplantation literature, it assesses the factors that have influenced the Maltese statutory and judicial process. Historical, cultural, economic, prestige and political factors and familiarity with the law are discussed.

It demonstrates that the Maltese statutory path has been influenced by the Italian legal system through the application of mandate law and thereafter by the English legal system with the inclusion of indirect influences, which started to prevail from the 1940s, and subsequently with the enactment of Article 136A of the Maltese Companies Act 1995 in 2003. However, it also indicates that the fiduciary duty in Articles 1124A and B of the Maltese Civil Code 1870 only have a Roman influence.

It concludes that, although the statutory regulation of this duty was linear and influenced by historical and cultural factors, most of the Maltese judiciary have been inconsistent in applying the law and has departed from the factors that influenced the legislators from the 1940s onwards by having started to apply the economic and prestige factors.

## **Dedication**

This thesis is dedicated to my daughter, Sherona Briffa Schembri, who is my rock and whose smile brightens my day, and also to my grandmothers Rose Saliba and Andreana Schembri who have always guided me from Heaven and encouraged me not to give up.

## **Acknowledgments**

I would like, first and foremost, to thank my tutors, Professor Rilka Dragneva-Lewers and Dr Katharina Moser, who have been by my side from the very beginning of this journey and who have always guided me and inspired me to keep strong. Their invaluable guidance, support and patience have been remarkable throughout these past four years, and I would not have been able to finish this thesis without them.

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## List of judgments

### Maltese judgments

*Advocate Doctor Andrew Borg Cardona noe v Priceclub (Holdings) Limited et* 12/10/2007  
(First Hall Civil Court) Cit. Nru. 24/3003

*Advocate Doctor Anthony H Farrugia as a special mandatary of the minors Fabienne Carbone and Rowan Carbone v Vernie Carbone for and on behalf of various companies and Agostino sive Winston Carbone, together with Advocate Dr. Eric Mamo, for and on behalf of other companies* 30/05/2001 (Court of Appeal) Cit. Nru. 82/1990/1

*Advocate Doctor Ian Refalo noe et v Albert David Boweck et* 18/03/1986 (First Hall Civil Court)

*Advocate Doctor Jean C Farrugia noe v Aqua Oasis Limited (C 41157) et* 06/10/1999 (Court of Appeal) Cit. Nru. 651/2008

*Advocate Doctor Victor Emanuel Ragonesi v Albert Stagno Navarro* 09/01/2009 (Court of Appeal) Cit. Nru. 771/2001/3

*Amadeo Balzan v Central Holidays (Travel and Tourism Ltd) and Alexandra Balzan Ruggier et* 16/06/2015 (First Hall Civil Court) Cit. Nru. 581/2011

*Anthony Caruana et v John Magro et.* 06/10/1999 (Court of Appeal)

*Anthony Caruana and Sons Limited et v Christopher Caruana* 28/02/2014 (Court of Appeal) Cit Nru. 573/2005/1

*Architect Mariello Spiteri v Registry of Companies et* 15/01/2015 (First Hall Civil Court) Cit. Nru. 778/2008

*Architect Raymond Vassallo pro et noe et v Anthony Parlato Trigona et* 30/09/2016 (Court of Appeal) Cit. Nru. 716/2011/1

*Attilio Vassallo Cesareo et noe vs Tony Cilia Pisani* 31/01/2003 (First Hall Civil Court)

*Borg v Camilleri* 07/04/1997 (First Hall Civil Court)

*Carmen Aquilina et v Edgar Ellul* 17/03/2003 (Court of Appeal)

*Catherine, wife of Joseph Galea v Milica Micovic* noe 19/11/2001 (Court of Appeal) Cit Nru. 271/93 GV,

*Central Holidays (Travel Agents and Organisers) Limited v Alexandra Balzan Ruggier et* 23/3/2015 (First Hall Civil Court) Cit. Nru 116/2011

*Charles Attard v Carmela Frendo* 31/01/2003 (First Hall Civil Court)

*Cordina v Cordina* 26/09/2007 (Court of Magistrates (Gozo) (Superior Jurisdiction))

*Deirdre and John Cachia v Gaba Diamonds Company Limited* 28/11/2003 (Court of Appeal) Cit. No. 2227/1998/1

*Edward and Giovanni Leone Enriquez v Advocate Doctor Anthony Farrugia et* 12/10/1989 (First Hall Civil Court)

*Emanuel Chircop pro et noe v Carmel sive Charles Busuttill et* 16/10/2015 (First Hall Civil Court) Cit. Nru. 651/2008

*Emmanuele Farrugia v Giovanna Lughermo* 29/10/1956 (Court of Appeal)

*Enemalta Corporation v Vella Group Limited and John Mary Vella* 08/06/2006 (Court of Appeal) Cit Nru. 1837/2004/1

*Executive Services Ltd v Therese Agius* 14/12/2001 (Small Claims Tribunal) Cit Nru. 1062/2001/1

*Francesco Saverio Musu' v Vincenzo di Saverio Vella et.* Vol. XII B page 527 11/11/1890

*Francis Busuttil and Sons Limited v Christopher Apap and Reflex Computer Systems (Malta) Limited* 30/05/2014 (Court of Appeal) Cit. Nru 331/1997/1

*Frank Cilia noe v Charles Scicluna* 27/04/1992 (Commercial Court)

*Giovanni Anastasi noe v Kaptan Serafino Xuereb M.B.E et* 14/06/1951 (Commercial Court)

*Jane Chircop et v Robert Mizzi pro et noe et.* 08/01/2015 (First Hall Civil Court) Cit. Nru. 735/2004

*John La Rosa noe v Carmelo Galea* 30/05/1958 (Court of Appeal) Vol. XLII.i.344

*John Veglio v Catherine Camilleri Catherine* 22/01/1973 (Court of Appeal)

*John Vella noe v Anthony Vella et* 03/12/1999 (Court of Appeal)

*Joseph Chetcuti noe v Peter Paul Camilleri* 04/12/1998 (Court of Appeal)

*Mark Hogg noe v Terra Sana Ltd et* 31/10/2016 (First Hall Civil Court) Cit. Nru. 607/13

*Messina v Galea* 05/01/1881

*Oreste Cilia pro et noe v Daniel Cilia pro et noe et.* 12/11/2013 (First Hall Civil Court) Cit. Nru. 1223/1997/1

*Philip Galea Souchet v Michael Falla* 04/05/1973 (Court of Appeal)

*Salvatore Coleiro v John Ellis* 04/02/1914 (Court of Appeal) (Vol. XXI.i.93)

*Salvatore Schembri v Salvatore Gauci* 31/10/1983

*Sirap Limited v IT 2010 Limited* 7/10/2013 (Court of Magistrates) Cit. Nru. 206/2010

*SRAM limited v Geomike Limited et* 18/11/2013 (Court of Magistrates) Cit. Nru 146/2011

*Vascas Enterprises Limited v Adrian Ellul* 13/11/2014 (First Hall Civil Court) Cit. Nru 111/2011

*Victor Grima noe v Anthony Grech* 09/12/1968 (Court of Appeal)

*Video On-Line Limited v Ian Giles* 25/02/2004 (Court of Appeal) Cit Nru. 339/2002/1

### **English judgments**

*Aberdeen Railway Co. v Blaikie Bros.* (1854) 1 Macq. 461 at p. 471

*Armstrong v Jackson* [1917] 2 KB 822

*Boardman v Phipps* [1967] 2 AC 46

*Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606

*Brady v Brady* [1988] BCLC 579

*Bray v Ford* [1896] AC 44

*Champagne Perrier-Jouet SA v HH Finch Ltd.* [1982] 1 W.L.R. 1359 (26 April 1982).

*Colin Gwyer & Associates Ltd. v London Wharf (Limehouse) Ltd.* [2003] BCC 885

*Crown Dilmun v Sutton* [2004] All ER (D) 222 (Jan)

*Currencies Direct Ltd. v Ellis* [2002] 1 B.C.L.C. 193 (19 October 2001)

*Daraydan Holdings Ltd. v Solland International Ltd.* [2004] EWHC 622, [2004] 3 WLR 1106; [2005] Ch 1

*Extrasure Travel Insurances Ltd. v Scattergood* [2003] All ER (D) 364 (Nov)

*Freeman & Lockyer v Buckhurst Park Properties (Magal) Ltd.* [1964] 2 QB 480

*Fulham Football Club v Cabra Estates plc.* [1994] BCLC 363

*Gencor ACP Ltd. v Dalby* [2000] 2 BCLC 734, [2000] EWHC 1560 (Ch), [2000] 2 BCLC 734

*Great Eastern Railway Co. v Turner* (1872) 8 Ch. 149

*Helmet Integrated Systems Ltd. v Tunnard* [2006] EWCA Civ 1735

*Hely-Hutchinson v Brayhead Ltd.* [1967] 1 QB 549

*Hogg v Cramphorn Ltd.* [1967] Ch. 254

*Howard Smith Ltd. v Ampol Ltd.* [1974] UKPC 3

*Industrial Development Consultants Ltd. v Cooley* [1972] 1 WLR 443

*Island Export Finance Ltd. v Umunna* [1986] BCC 460

*J J Harrison (Properties) Ltd. v Harrison* [2002] 1 BCLC 162

*Jonathan Ball v Eden Project Ltd.* [2001] All ER (D) 128 (Apr)

*Keech v Sandford* [1726] 25 ER 223

*Kregor v Hollins* (1913) 109 LT 225

*Lee Panavision Ltd. v Lee Lighting Ltd.* [1992] BCLC 22 (C.A.)

*London and Mashonaland Exploration Co. v New Mashonaland Exploration Co.* [1891] WN  
165

*Norman v Theodore Goddard* [1999] B.C.L.C. 1028

*Parker v McKeena* (1874) 10 Ch. App. 96

*Piercy v Mills & Co. Ltd.* [1920] 1 Ch. 77

*Ranson v Customer Systems plc* [2012] EWCA Civ 841

*Re Punt vs Symons & Co Ltd.* [1903] 2 Ch. 506

*Re W & M Roith Ltd.* [1967] 1 WLR 432

*Regal (Hastings) Ltd. v Gulliver* [1942] UKHL 1

*Regentcrest plc v Cohen* [2001] 2 BCLC 80

*Royal British Bank v Turquand* (1856) 6 E&B 327

*Scottish Cooperative Wholesale Society Limited v Meyer* [1959] AC 324

*Shepherds Investments Ltd. and Shepherds (Financial) Ltd. v Andrew Walters* [2006] EWHC 836 (Ch)

*Smith & Fawcett Ltd.* [1942] Ch. 304

*Teck Corp Ltd v Millar* (1972), 33 DLR (3d) 288 (BCSC)

*Thorby v Goldberg* (1964) 112 CLR 597

*University of Nottingham v Fishel* [2000] EWHC 221 (QB) (19 January 2000)

*West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250

*Winkworth v Edward Baron Development Co Ltd.* [1986] 1 WLR 1512

### **New Zealand judgment**

*Korbond Industries Ltd. v Jenkins* [1992] 1 ERNZ 1141 (EMC) at 1150

## **List of statute law**

### **Maltese statute law**

#### **Acts**

Act XXX of 1927

Civil Code, Chapter 16

Code of Organisation and Civil Procedure, Chapter 12

Commercial Code 1942

Companies Act, Chapter 386

Constitution of Malta

Small Claims Tribunal, Chapter 380

#### **Ordinances**

Ordinance XIII 1857

Commercial Partnerships Ordinance 1962, Chapter 168

### **English statute law**

Companies Act 1948

Companies Act 1985

Companies Act 2006

### **Italian statute law**

Codice Civile 1865

Codice Civile 1942

Codice di Commercio 1865

Codice di Commercio 1882

### **French statute law**

Code Civil 1804

Code de Commerce 1807

# Contents

Abstract.....	ii
Dedication.....	iii
Acknowledgments.....	iv
List of judgments.....	v
Maltese judgments.....	v
English judgments.....	viii
New Zealand judgment.....	x
List of statute law.....	xi
Maltese statute law.....	xi
English statute law.....	xi
Italian statute law.....	xii
French statute law.....	xii
Contents.....	xiii
Chapter 1. Introduction: themes, approach and structure of the thesis.....	1
1.1    The research question.....	1
1.2    Reasons to examine this research question.....	2
1.2.1    Malta as a mixed jurisdiction with a mixed legal system.....	2
1.2.2    The business sector in the Maltese economy.....	5
1.2.3    The judicial landscape in Malta.....	8
1.2.4    Lack of Maltese literature on legal transplantation in corporate law.....	11
1.3    Structure of the thesis.....	12
1.4    Research methodology – legal transplantation.....	14
Chapter 2. The sources of the Italian, English, European and international systems.....	35
2.1    Introduction.....	35
2.2    The influence of Roman law on the evolution of the regulation of the fiduciary duty of directors.....	36
2.2.1    Introduction.....	36
2.2.2    Trust law.....	37
2.2.3    Fiduciary law.....	39
2.2.4    Mandate law.....	40
2.2.5    Agency law.....	41
2.3    The evolution of the fiduciary duty of directors in the Italian Legal System.....	43

2.3.1	Introduction.....	43
2.3.2	Mandate law.....	44
2.3.3	Fiduciary law .....	46
2.4	The evolution of the fiduciary duty of directors in the English legal system ..	48
2.4.1	Introduction.....	48
2.4.2	Trust Law .....	50
2.4.3	Agency law .....	60
2.4.4	Fiduciary law .....	63
2.5	The evolution of the fiduciary duty of directors in the European Union.....	69
2.6	The evolution of the fiduciary duty of directors as presented by the international organisations .....	72
2.7	Conclusion .....	74
Chapter 3.	The development of the fiduciary duty of directors in Malta .....	76
3.1	Introduction.....	76
3.2	The application of mandate law in Malta .....	77
3.2.1	Reasons to consult the Italian mandate law .....	81
3.2.1.1	Factors that influenced legislators.....	81
3.2.1.1.1	Historical, cultural and societal factors.....	81
3.2.1.1.2	Familiarity with the law .....	84
3.2.1.2	The judicial factor and the influence of the prestige and economic factors.....	87
3.3	The application of fiduciary law in Malta.....	88
3.3.1	Reasons to consult English fiduciary law .....	90
3.3.1.1	Factors that influenced legislators.....	90
3.3.1.1.1	Historical, cultural and societal factors.....	90
3.3.1.1.2	Familiarity with the law .....	91
3.3.1.2	The judicial factor and the influence of the prestige and economic factors.....	93
3.4	Conclusion .....	95
Chapter 4.	The fiduciary duty of directors under the Maltese statutory legal system.....	97
4.1	Introduction.....	97
4.2	History of the definition of a director under the Maltese legal system.....	98
4.3	The statutory fiduciary duty of directors before 2003 .....	102
4.3.1	Duty to act in good faith and in the best interests of the company.....	106

4.3.2	Duty to promote the wellbeing of the company and responsibility for its general governance and supervision .....	111
4.3.3	Duty not to make secret or personal profit without the consent of the company, nor make personal gain from confidential company information .....	114
4.3.4	Duty not to let personal interests conflict with the interests of the company .....	117
4.3.5	Duty not to use any property, information or opportunity of the company for personal or anyone else’s benefit or obtain any benefit from their power, except with the consent of the company at the general meeting or as permitted by the memorandum and articles of the company .....	123
4.3.6	Duty to exercise the powers they were given and not to misuse those powers .....	126
4.4	The statutory fiduciary duty of directors after 2003 .....	136
4.4.1	Duty to act in good faith and in the best interests of the company .....	137
4.4.2	Duty to promote the wellbeing of the company and responsibility for its general governance and supervision .....	153
4.4.3	Duty not to make secret or personal profit without the consent of the company, nor make personal gain from confidential company information .....	155
4.4.4	Duty not to let personal interests conflict with the interests of the company .....	160
4.4.5	Duty not to use any property, information or opportunity of the company for personal or anyone else’s benefit or obtain any benefit from their power, except with the consent of the company at the general meeting or as permitted by the memorandum and articles of the company .....	164
4.4.6	Duty to exercise the powers they were given and not to misuse those powers .....	167
4.5	Directors’ statutory fiduciary duty as applied under Articles 1124 A and B of the Maltese Civil Code 1870 and as interpreted by the courts .....	172
4.6	Conclusion .....	176
Chapter 5. The Maltese Courts and their conflicting interpretations of the fiduciary duty of directors.....		179
5.1	Introduction.....	179
5.2	The Maltese judicial system.....	180
5.2.1	The Court of Appeal.....	181
5.2.2	The First Hall Civil Court.....	182
5.2.3	The Commercial Court.....	183
5.3.4	The Small Claims Tribunal.....	183
5.3	The applicable law to directors .....	183

5.3.1	Cases filed before 2003.....	185
5.3.1.1	Applicability of mandate law or any other provision enacted in the Commercial Ordinances or Acts that supersedes the law of mandate.....	185
5.3.1.2	Applicability of the English legal system when an uncertainty is present.....	195
5.3.1.3	Applicability of Article 136 A of the Maltese Companies Act 1995, together with the law of mandate.....	196
5.3.2	Case law filed post-2003.....	200
5.3.2.1	Applicability of Article 136 A of the Maltese Companies Act 1995 only.....	200
5.3.2.2	Applicability of Article 136 A of the Maltese Companies Act 1995 and the fiduciary provisions of the Maltese Civil Code 1870.....	202
5.3.2.3	Applicability of mandate law together with Article 136 A of the Maltese Companies Act 1995 and the fiduciary provisions of the Maltese Civil Code 1870.....	204
5.3.2.4	Applicability of mandate law only.....	207
5.4	Conclusion .....	210
Chapter 6.	Conclusion .....	211
6.1	Key findings.....	213
6.1.1	Borrowing from the Italian and English legal systems.....	214
6.1.1.1	Comparison between the Maltese and Italian legal systems.....	217
6.1.1.2	Comparison between the Maltese and English legal systems.....	219
6.1.2	Influence exerted by the Roman law on the Maltese Civil Code 1870 provisions.....	225
6.1.3	The approach taken by the majority of the Maltese judiciary distinct from statute law; thus leading to judicial nihilism.....	226
6.1.4	A general approach to legal transplantation in the Maltese legal system	227
6.2	Explanatory factors .....	228
6.3	Wider implications and the relevance of studying the complexities of Malta .....	232
Bibliography	.....	239
Books	.....	239
Journal articles	.....	244
Websites	.....	251
Thesis	.....	266
Speeches	.....	267
Appendix	.....	268

Maltese Statute Law .....	268
English Statute Law.....	295
Italian Statute Law.....	304
French Statute Law.....	305

# **Chapter 1. Introduction: themes, approach and structure of the thesis**

## **1.1 The research question**

The objective of this thesis is to examine the development of the fiduciary duty of company directors under Maltese corporate law as an example of legal transplantation through the Maltese statutory and judicial approach.

It will be seen that legislatures in Malta were always very much influenced by the historical, cultural and societal factors, together with their familiarity with the law, from the 1800s. However, the majority of the judiciary's desire from the 1940s was to form a legal system that attracts foreign investment, as opposed to creating one driven by sentiment presented through the historical, cultural and societal factors, which has led judicial practice to deviate from the statutory approach. This judicial deviation has given rise to problems of inconsistency between the judgements delivered and statute law; thus leading to judicial nihilism.<sup>1</sup> Judicial nihilism, therefore, shall be defined as those instances whereby most of the judiciary were not applying the law as it was enacted by the legislators but were departing from such definitions of the law to apply the law they deemed appropriate. In view of this, it is observed that these diverse factors mentioned herein have led to the evolution of the fiduciary duty of company directors

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<sup>1</sup> As at to date, there exists no literature that define the term judicial nihilism. However, this term was formulated on the premise of the definition of nihilism in general, as presented by Joseph William Singer, 'The Player and the Cards: Nihilism and Legal Theory' 94 Yale L.J. (1984) <<https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=6890&context=yjlj>> accessed 16 September 2019. More precisely, the term legal nihilism was formulated over time by various legal scholars, which is defined as a negative attitude towards a particular law, as presented by Jahor S. Azarkievič, 'Legal nihilism as an obstacle to the rule of law in Russia', University of Glasgow, December 2016, who refers to various scholars. Therefore, the term judicial nihilism was formulated to demonstrate the majority of the judiciary's unacceptance of the law that was in force at that particular moment in time

in Malta to change remarkably over these past two hundred years, ultimately no longer deriving from the Italian civil legal system, but rather from the application of English common law through the process known as legal transplantation.

The persistence of the influence of Roman law throughout the years will also be examined, as it is the backbone of both the common and civil law on which the English and Italian legal systems are respectively founded, and which have shaped the Maltese legal system. The direct influence of the Roman law on the Maltese legal system, without making any reference to the Italian and English legal systems, will also be explored due to the remarkable changes which came about in 2004.

## **1.2 Reasons to examine this research question**

An examination of the Maltese legal system with regards to the fiduciary duty of directors through an analysis of the concept of legal transplantation is significant for several reasons, which can be brigaded under four sub-headings: the consequence of considering the Maltese mixed jurisdiction bearing a mixed legal system; the importance of the business sector in the Maltese economy; the judicial approach in Malta that deviates significantly from the statutory path; and the lack of Maltese literature on legal transplantation in Maltese corporate law.

### **1.2.1 Malta as a mixed jurisdiction with a mixed legal system**

An examination of the development and interpretation of the fiduciary duty of directors under the Maltese legal system, through the legal transplantation concept, is an interesting topic of analysis because it demonstrates that Malta bears a mixed legal system, as specifically

described and categorised by various scholars.<sup>2</sup> A mixed legal system can be defined and considered as legal pluralism wherein ‘laws, methods, techniques, or legal institutions [are] drawn from another tradition or foreign system’<sup>3</sup> to form one unique legal system. Malta is consequently categorised as enjoying a mixed jurisdiction as it enjoys a mixed legal system. It has been so categorised by various legal scholars, including Biagio Ando’,<sup>4</sup> who says that Malta is a mixed jurisdiction because it shows an overlap ‘between the continental legal traditions, which lies at the basis of the Maltese legal tradition, with the English one.’<sup>5</sup> This same definition and explanation is again provided by Palmer.<sup>6</sup>

In view of this, this study will demonstrate that Malta falls under the category of a mixed jurisdiction due to the influences derived from the civil system through the application of the Italian legal system and of the common law system through the English legal system. This island nation was, in fact, conquered by various invaders who first introduced the Italian influence (vide Chapter 3), and although later conquered by the British who introduced their

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<sup>2</sup> William Tetley, (2000) ‘Mixed Jurisdictions: common law vs civil law (codified and uncoded)’ <<http://www.cisg.law.pace.edu/cisg/biblio/tetley.html> > accessed 29 November 2016. Palmer believes that ‘despite the indisputable diversity of peoples, cultures, languages, climates, religions, economies, and indigenous laws existing among them, [these two legal systems] share some characteristics’. He further notes that this ‘coexistence of different roots is accepted and considered obvious by those who live and work within those legal systems’ (Mixed Legal Systems, East and West, Routledge, 2016). The eminent Scottish comparatist Sir Thomas Smith also makes reference to similar mixed legal systems, describing them as being ‘basically a civilian system that had been under pressure from the Anglo-American common law and has in part been overlaid by that rival system of jurisprudence’ (A Mixed Legal System in Transition, Edinburgh Studies in Law, July 2005). Other writers, however, believe that an unambiguous definition of mixed jurisdictions has never been provided, although they still believe that a mixed jurisdiction is one that shows a mixed legal system: B Ando’, ‘As Slippery as an Eel? Comparative Law and Polyjural Systems’, (2015) in Palmer, V.V, Mattar M. Y. and Koppel A (eds.) *Mixed Legal Systems, East and West*. United Kingdom: Ashgate Publication, pp. 3-16; Palmer, V.V (2012) ‘The Mixed Jurisdiction in Profile: Three Characteristics’, in Palmer, V.V (ed.) *Mixed Jurisdictions Worldwide: The Third Legal Family*. Cambridge, UK: Cambridge University Press.

<sup>3</sup> Vernon Valentine Palmer, ‘Mixed Legal Systems...and the Myth of Pure Laws’ [2007] Volume 67 Number 4 Louisiana Law Review 1205 <<https://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?article=6210&context=lalrev>> accessed 13 March 2018

<sup>4</sup> Biagio Ando’, Kevin Aquilina, J, Scerri-Diacono and David Zammit (2012) ‘Malta’, in Palmer V (2<sup>nd</sup> ed.) *Mixed Jurisdictions Worldwide: The Third Legal Family*. Cambridge, UK: Cambridge University Press, pp. 528-576

<sup>5</sup> Ibid.

<sup>6</sup> Palmer (n 2) pp. 3-16

own influences, the Italian influence could not be totally disregarded and both influences were applied concurrently for a long period of time. These influences have resulted in the statutory regulation of the fiduciary duty of directors in Malta being influenced by the civil legal system with regards to the applicability of the mandate law, while the scattered provisions enacted in the 1960s under the Maltese Commercial Codes have been influenced by the English legal system. The statutory application of these two concurrent legal systems continued until 2003, where from then on the common law system alone was applied, which led to the enactment of the Article 136 A of the Maltese Companies Act 1995. The judiciary was also influenced by these two foreign systems wherein they applied the Italian legal system until the 1940s, but the most of the judiciary have thereafter departed ways whereby some judges and magistrates started to apply the English legal system from the 1940s whereas other judges and magistrates continued to refer to the Italian legal system even after 2003. In addition to such change, the direct influence of the Roman law is also observed in the 2004 enactment of Articles 1124 A and B of the Maltese Civil Code 1870; therefore, the influence of the civil legal system was once again predominant.

Accordingly, this study will demonstrate that there are continuous instances where such cordial blending of these two different legal systems arises under the Maltese statute law, even if such coexistence is not automatically clear from the statute law itself and even though differences exist between the civil and common legal systems. In fact, the civil system is based on codified laws,<sup>7</sup> which can be interpreted differently by different actors without being bound by the rule of precedent. By contrast, the common law entails that legal rules are not enacted through

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<sup>7</sup> J.G. Sauveplanne, 'Codified and Judge Made Law: The Role of Courts and Legislation in Civil and Common Law Systems' [1981] Volume 45 Number 4 <<http://www.dwc.knaw.nl/DL/publications/PU00009908.pdf>> accessed 13 March 2018

Codes, but rather lie in precedents, which are created from concrete cases delivered by superior Courts.<sup>8</sup>

### **1.2.2 The business sector in the Maltese economy**

It is also important to study the fiduciary duty of directors in Malta because the business sector fuels the Maltese economy. Although many different sectors compose the Maltese economy, including construction, manufacturing and agriculture, there has recently been a shift in the pattern, and financial services, information technology and other professional activities have continued to grow while agricultural activity has dwindled.<sup>9</sup> Such shift has led the legislators in Malta to enact more regulatory laws that need to be thoroughly observed due to the business nature of these sectors, such as the enactment of and abiding by Article 136 A of the Companies Act 1995. These laws eventually boost its economy and the financial services, which have, accordingly, led to the financial services sector, including corporate services, to continue to thrive in the Maltese economy during the past decade, especially after the financial crisis of 2008<sup>10</sup> when the Maltese economy was able to show great resilience. The HSBC Bank Malta's head of global banking and markets, Chris Bond, also openly described such resilience in 2013.<sup>11</sup> Indeed, the effects of the 2008 financial crisis led the corporate and financial sectors to become two of the main spheres of activity that power the Maltese economy and they currently

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<sup>8</sup> Judicial Office, 'The judicial system of England and Wales: A visitor's guide' <<https://www.judiciary.uk/wp-content/uploads/2016/05/international-visitors-guide-10a.pdf>> accessed 13 March 2018

<sup>9</sup> Finance Malta, 'The Financial Crisis – A Decade Later' (2017) <<https://www.financemalta.org/sections/banking/members-articles/detail/the-financial-crisis-a-decade-later-2017/>> accessed 13 April 2018

<sup>10</sup> Reference to this financial crisis is deemed appropriate as the 2008 financial crisis was the last biggest financial crisis that has hit the world

<sup>11</sup> Malta Independent, 'Maltese economy's 'resilience' in financial crisis understood' (2013) <<http://www.independent.com.mt/articles/2013-05-29/news/maltese-economys-resilience-in-financial-crisis-underscoring-1711276035>> accessed 25 April 2018

contribute twelve percent of Malta's GDP, a figure thought likely to grow with the establishment of more financial services companies in Malta.<sup>12</sup> The success of the Maltese financial services economic growth is also acknowledged by the chairperson of the Malta Financial Services Authority who stated asserted in the 2017 financial report that:

‘the contribution of the financial services sector to the economy showed a contribution of over 11% which compares favourably with other finance centres such as London and Dublin [...] Financial services and insurance continue account for over 90% of Foreign Direct Investment into Malta’.<sup>13</sup>

This study also notes that these different sectors, which ultimately form the business sector, can be formed as limited liability companies. Indeed, the importance of this business sector in Malta is manifested in the fact that the number of limited liability companies is relatively large in comparison to the size of the Maltese islands.<sup>14</sup> If the population of Malta (just over four hundred thousand people<sup>15</sup>) is compared to the number of companies thus far formed in Malta, the number of limited liability companies is quite high. In fact, by the end of the year 2017, there were 84,503 companies,<sup>16</sup> with 5,330 formed in 2017 alone. These companies formed in 2017 are split into 27 public limited liability companies and 5,303 private limited liability

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<sup>12</sup> Times of Malta, ‘Financial Sector could grow to 15% of GDP – survey’ (2017) <<https://www.timesofmalta.com/articles/view/20170919/local/financial-sector-could-grow-to-15-of-gdp-survey.658392>> accessed 25 April 2018

<sup>13</sup> Malta Financial Services Authority, ‘Annual Report 2017’ (2017) <<https://www.mfsa.com.mt/pages/viewcontent.aspx?id=45>> accessed 25 April 2018

<sup>14</sup> The Maltese islands are composed of Malta, Gozo, Comino and other small islands, although only the first two are inhabited

<sup>15</sup> Worldometers, ‘Malta Population’ <<http://www.worldometers.info/world-population/malta-population/>> accessed 27 April 2018

<sup>16</sup> Malta Financial Services Authority (n 13)

companies.<sup>17</sup> There are also 46 listed companies, all constituted as public limited liability companies, formed until to date.<sup>18</sup>

This thesis will also examine the statutory application of the fiduciary duty of directors in family run businesses, which the majority of them are being directed and held by the same person and they are mainly formed as private limited liability companies.<sup>19</sup> The majority of the companies formed in Malta are indeed family run business,<sup>20</sup> something acknowledged by the President of the Malta Chamber of Commerce, Enterprise and Business, Frank V Farrugia, who asserted that ‘there is literally a family business on every street in Malta [...] Often described as the soul of the economy, family businesses hold a crucial role in the economic growth of any country’.<sup>21</sup> Accordingly, this study will present why the directors of such distinctive company formations must thoroughly conform to their duties for two main reasons, as other directors of other companies. First, if directors take into consideration the interests of stakeholders, they will ultimately generate more profits into their own pockets. Second, small private companies can still employ a big number of employees and interact with many stakeholders, whose interests cannot be undermined due to the first reason already expressed, even though at first glance it might seem that these directors of such companies do not need to

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<sup>17</sup> National Statistics Office Malta <<https://nso.gov.mt/en/Pages/NSO-Home.aspx>> accessed 26 April 2018. In 2015, there were 5,487 private limited liability companies and 68 public limited liability companies formed. In 2016, there were 5,137 private limited liability companies and 77 public limited liability companies formed. Data retrieved can also be accessed via email sent to this Office

<sup>18</sup> Malta Stock Exchange plc, ‘Official List’ (2018) <[https://www.borzamalta.com.mt/download/Official\\_list/official\\_list.pdf](https://www.borzamalta.com.mt/download/Official_list/official_list.pdf)> accessed 12 December 2018

<sup>19</sup> Malta Financial Services Authority <[www.mfsa.com.mt](http://www.mfsa.com.mt)> accessed 6 April 2018

<sup>20</sup> Finance Malta, ‘Malta enacts Family Business Legislation’ <<https://www.financemalta.org/publications/articles-interviews/articles-and-interviews-detail/malta-enacts-family-business-legislation/>> accessed 10 April 2018. Malta was one of the first European Union countries to enact the Family Business Act, which regulates family businesses and their succession

<sup>21</sup> Jo Caruana, ‘Challenges, Success and Succession: Family Business in Malta’ (2018) (MaltaChamber) <<https://www.maltachamber.org.mt/en/challenges-success-and-succession-family-business-in-malta>> accessed 20 September 2018

rigorously abide by their fiduciary duty. These companies, which amount to some 98% of the businesses in Malta, are categorised as small and medium enterprises,<sup>22</sup> and they account for more than 82% of the Maltese economy, some 25% higher than any other EU country.<sup>23</sup> This study will, consequently, also provide an answer why this unique type of company formation led to so few *res judicata*<sup>24</sup> judgments to have been filed in Malta, which challenge the statutory application and interpretation of the fiduciary duty of directors until the present date since this duty can only be challenged by one director in the name of the company against another director.

### **1.2.3 The judicial landscape in Malta**

This study will also reveal the inconsistent judicial approach from the swift legal statutory change in the area of the fiduciary duty of directors. The reason for this inconsistency can be explained by the persistence of the majority of the judiciary in recommending a legal system that endorses an economic objective, which brings with it a degree of prestige to the judiciary itself, rather than forming a legal system that is influenced by sentiment through the historical, cultural and societal factors, together with the familiarity with the law. This approach taken by most of the judiciary has led to application of the concept of judicial nihilism, as defined above under Section 1.1.

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<sup>22</sup>PricewaterhouseCoopers, 'Family Business Strategy 2016, Bridging the strategy gap in Maltese Family Businesses' (2016)

<<https://economy.gov.mt/en/familybusinessact/Family%20Business/Documents/PwC%20Malta%20-%20Family%20Business%20Survey%202016.pdf>> accessed 10 September 2018

<sup>23</sup> European Commission, 'Commission Staff Working Document, Country Report Malta 2018' (2018) <<https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-malta-en.pdf>> accessed 15 August 2018

<sup>24</sup> This phrase, which is widely used in the Maltese legal system, refers to a judgment that cannot be further challenged and appealed and the judgment shall, therefore, be considered as final

However, although most of the Maltese judiciary have very much drawn to the economic factor, this thesis also suggests that the underdeveloped judicial system, and therefore the approach taken by most of the judiciary to still take into consideration the historical, cultural, societal and familiarity with the law factors, has regrettably led to the hindrance of fully endorsing the economic factor in its entirety.

The Maltese judiciary was able to endorse any factor that it deems appropriate due to the various restrictions that will be presented in this section.<sup>25</sup> To better understand the background of these limitations, reference shall first be made to the fact that the Maltese judiciary needs to only attend a law course at the University of Malta and practise as a lawyer for a specific number of years in the Maltese Courts.<sup>26</sup> Moreover, members of the Maltese judiciary are appointed by the President of Malta having first provide their nomination to a committee, which scrutinises their eligibility under the Maltese Constitution,<sup>27</sup> and their ability to adhere to the judicial code of ethics and to be in a position to deliver justice in a timely manner. To be appointed a judge, one must have practised as an advocate or a magistrate in Malta for not less than twelve years, either continuously or in the aggregate. By contrast, one must serve as an advocate for a period of seven years to be eligible for appointment as a magistrate. If the committee is satisfied that a person can be appointed to the judiciary, it will then advise the Prime Minister who will in return advise the President of Malta. The President of Malta ultimately appoints the individual.

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<sup>25</sup> Kevin Aquilina, 'Inconsistent judgments' (2012) <<https://www.timesofmalta.com/articles/view/20120720/opinion/Inconsistent-judgements.429319>> accessed 16 August 2018

<sup>26</sup> Vide Articles 96 and 100 of the Constitution of Malta <<http://justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8566>> accessed 17 August 2018

<sup>27</sup> Ibid.

The second limitation is that Maltese judges and magistrates are, regrettably, not fully trained in the common law and civil legal traditions, and are also not viewed as experienced in researching English and Italian case law. Such limitation can be viewed from the way that they have applied the statute law in the regulation of the fiduciary duty of directors (vide Chapter 5).

Another limitation very much tied to the above restriction is that the majority have not studied either in the United Kingdom or in Italy, meaning that they are often not in a position to fully comprehend the English and Italian legal systems.

Another obstacle is the linguistic barrier. Knowledge of Italian is not a requirement to study law in Malta; thus, the majority of the Maltese judiciary often cannot speak it and thus cannot fully understand either the Italian legal system or the Maltese *res judicata* judgments, which were delivered in Italian by the Maltese Courts at the beginning of the 19<sup>th</sup> century, but are still valid today.

An additional restriction in this instance is that the law of precedent<sup>28</sup> does not hold ground in Malta. Consequently, judges and magistrates have decided differently on cases that are similar

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<sup>28</sup> Paul J Watford, Richard C Chen and Marco Basile, 'The Law of Judicial Precedent' (Book Review, Crafting Precedent) <[https://harvardlawreview.org/wp-content/uploads/2017/12/543-580\\_Online.pdf](https://harvardlawreview.org/wp-content/uploads/2017/12/543-580_Online.pdf)> accessed 2 August 2018, pp. 543

in their pleas; therefore, legal-minded people have frequently reached different and sometimes even totally opposite conclusions, as will be shown in Chapter 5.

One final limitation is that in Malta judges and magistrates do not have to show a certain degree of knowledge in one particular field of law. Instead, they can preside and decide on all cases without having any particular knowledge or training.<sup>29</sup>

#### **1.2.4 Lack of Maltese literature on legal transplanted in corporate law**

The subject of the regulation of the fiduciary duty of directors in Malta is furthermore interesting to look into because although the current law has been in force for the past sixteen years, it has not yet been critically examined by Maltese legal researchers and scholars until to date; the one exception is that of Professor Andrew Muscat<sup>30</sup> who published one book<sup>31</sup> in 2007 about Maltese company law, including the notion of the fiduciary duty of directors. However, he merely presents the current legal codified position of the fiduciary duty of directors (as had changed in 2003) and the English position in general and does not delve deeply into the historical background that has led to the statutory amendment to this fiduciary duty. Neither does he discuss the approach taken by the Maltese Courts when interpreting and applying the fiduciary duty to the cases presented before the Courts or the reasons why most of the Maltese judiciary have felt the need to depart from the path taken by Maltese statute law.

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<sup>29</sup> The Constitution of Malta (n 26). The Maltese Constitution provides how the judiciary is appointed and also the approach taken when there is a vacant office. The Maltese Constitution does not go into the merits of competency; therefore this requisite is not necessary to be appointed part of the judiciary

<sup>30</sup> Certain other Maltese legal writers have co-written short articles on company law in general, and/or on civil law in general, but there have not been any business and financial press written in Malta or outside Malta on this context with particular reference on Malta

<sup>31</sup> Andrew Muscat, *Principles of Maltese Company Law* (1<sup>st</sup> edn, Malta University Press 2007)

### **1.3 Structure of the thesis**

Following this introductory chapter, which will present the general framework of the concept of legal transplantation, in Chapter 2 the focus is shifted to the Italian and English legal regimes, as they form the backbone of the Maltese legal system. It will present the origin and application of the main suppliers (or ‘donors’) of law that have regulated the fiduciary duty of directors, thus facilitating an understanding of which specific donors have influenced the Maltese legal system. Trust law, agency law, mandate law and fiduciary law will be thoroughly looked into and analysed. The weak influences of the European Union and other international organisations in their regulation of the fiduciary duty of directors shall also be presented.

Chapter 3 will analyse the effect of legal transplantation throughout the history of the Maltese legal system. The reasons that have led legislators to consider certain factors when drafting the Maltese law to regulate the fiduciary duty of directors throughout the years will be looked into, while the other factors taken into account by the Maltese judiciary will also be considered. In general, it will be shown that whereas legislators in Malta have been strongly influenced by historical, societal and cultural factors, together with the familiarity with the law, from the 1800s onwards, prestige and economic effect have been of more interest to the majority of the judiciary from the 1940s, who have thus departed from the path taken by statutory development. The primary focus will be on the period from the 19<sup>th</sup> century until the present day, as it was not until the 19<sup>th</sup> century that the first statute law in Malta came into force and only then did recorded judgments become available.

The factors that influenced the Maltese statutory process will be reviewed in Chapter 4 by examining the statutory provisions enacted in Malta to regulate the fiduciary duty of directors.

This Chapter will also present a systematic comparative appraisal of the Maltese, Italian and English legal systems. The mandate law will be examined in light of its Italian influences, while article 136 A of the Maltese Companies Act 1995,<sup>32</sup> together with its ancillary provisions, Articles 1124 A and B of the Maltese Civil Code 1870,<sup>33</sup> will be analysed in light of its English and Roman influences. The study will present the various instances of verbatim copying of statutes from both the common and civil legal systems, and instances wherein these two legal systems have not influenced Maltese statutory provisions. Again, the main period of interest for this part of the study will be from the 19<sup>th</sup> century to the present day.

Chapter 5 will go on to illustrate that the factors analysed in Chapters 1 and 3 have led the judicial practice to deviate from the path taken by Maltese statute law, which has resulted in problems as Maltese statute law has not been faithfully translated into judicial practice.<sup>34</sup> This section will involve scrutinising the case law that has become *res judicata*<sup>35</sup> before the Maltese Courts. More precisely, it will show that whereas the majority of the judiciary was interested in applying the economic and prestige factors, other judges and magistrates still held on to the historical, cultural, societal and familiarity with the law factors and did not feel the need to look at the economic and prestige factors with importance. As a result, it will demonstrate that although certain cases were filed before 2003, the mandate law was applied, together with Article 136 A of the Companies Act 1995 (enacted in 2003) and the fiduciary provisions (enacted in 2004). A similarly dissatisfactory approach, albeit one that presents the other side

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<sup>32</sup> Chapter 386 of the Laws of Malta <<http://www.justiceservices.gov.mt/LOM.aspx?pageid=27&mode=chrono>> accessed 10 September 2013

<sup>33</sup> Chapter 16 of the Laws of Malta <<http://www.justiceservices.gov.mt/LOM.aspx?pageid=27&mode=chrono>> accessed 10 September 2013

<sup>34</sup> For the purposes of this study, judicial practice is limited to the court cases that are *res judicata* and that were decided by the Maltese Courts

<sup>35</sup> This phrase, which is widely used in the Maltese legal system, refers to a judgment that cannot be further challenged and appealed and the judgment shall, therefore, be considered as final

of the coin, was applied in other judgments wherein although these other cases were filed after 2003, Article 136 A of the Companies Act 1995 and the mandate law were applied. These *res judicata* judgments will be split according to the date that they were filed in Court to facilitate a better assessment of the discrepancies that arise between the applicability of the statute law and judicial practice in Malta, since the filing date determines what law should have been applied to that particular case.

Finally, Chapter 6 will seek to contribute to the broader debate on legal transplantation with a specific focus on the Maltese context. It will scrutinise the patterns observed in the Maltese statutory and judicial approaches, identifying, in particular, the gaps between the Maltese and the foreign statute laws. It will, thereafter, suggest any amendments that may be necessary to be carried out to the statute law and to the judiciary while also examining the rationale that might have led to these gaps.

#### **1.4 Research methodology – legal transplantation**

An examination of the regulation of the fiduciary duty of directors in Malta can only be attempted if one understands the implications and significance of the various factors that form the transplanted legal concept, which have structured the path taken by both the Maltese statute law and the Maltese judicial practice throughout the past two hundred years. These factors demonstrate why the Maltese statute law and most of the Maltese judiciary have taken different paths in applying the relevant law with respect to the regulation of the fiduciary duty of directors. This examination will draw on the vast literature on legal transplants dealing with the various factors that have led to the adoption or rejection of legal transplantation.

Before delving into the implications and applications of legal transplantation in Malta, it is first important to define the concept of legal transplantation and determine what it represents and whether it can be applied in the Maltese context at all. In very broad and basic terms, transplantation can be defined as the movement of law from one legal jurisdiction to another, which generally occurs via a conscious process of law-making or legal reform.<sup>36</sup> Accordingly, it can take place by transposition, imposition, reception or intended borrowing.<sup>37</sup> While the concept of legal transplantation has been implicitly recognised for a very long time,<sup>38</sup> this concept was first formally formulated by Professor Kahn-Freund in June 1973 during a lecture at the London School of Economics.<sup>39</sup>

Nonetheless, although the definition of legal transplantation is worthy of an analysis in its own right, legal scholars seem to be more interested in the success or failure of legal transplantation rather than its specific meaning. In fact, the acceptance or otherwise of legal transplantation has been the subject of a vast body of literature.<sup>40</sup> The success or inadequacy of this process can be clearly observed through the extent to which one legal system adapts its own principles and procedures in line with those of foreign legal systems, a process known as transplant effectiveness. Indeed, transplant effectiveness can be more precisely defined as: ‘the root of

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<sup>36</sup> Tatiana Kyselova, ‘The Concept of Legal Transplant: Literature Review’ in the Centre for Socio-Legal Studies, University of Oxford [2008]

<sup>37</sup> Chen Lei, ‘Contextualising Legal Transplant: China and Hong Kong’ in Monateri, P.G. (ed.) *Methods of Comparative Law*. (2012) United Kingdom: Edward Elgar Publishing Limited, 192

<sup>38</sup> Kyselova (n 36)

<sup>39</sup> Antonina Bakardjieva Engelbrekt, ‘Legal and Economic Discourses on Legal Transplants: Lost in Translation?’ in Semantic Scholars <<https://pdfs.semanticscholar.org/4668/1780ec4dcad585c3ff56262b48e241cdc89f.pdf>> accessed 10 September 2013

<sup>40</sup> Nuno Garoupa and Anthony Ogus, ‘A Strategic Interpretation of Legal Transplants’ *The Journal of Legal Studies*, 35(2), 339-363

the transplant effect lies in the relationship between the formal, written source of the law, and unwritten conventions, norms and practices inherent in the legal system'.<sup>41</sup>

From the extensive literature on transplant effectiveness, it can be seen that some writers (referred to as culturalists<sup>42</sup>) have denounced the significance of legal transplantation in the field of law and condemned any acceptance of legal transplantation. These culturalists contend that the effectiveness of legal transplantation is hindered by the geographical, historical, economic, cultural, political, judicial discretion and prestige influences of a particular legal system and thus, they reject any notion of the effectiveness of transplantation. They assert that the legal transplantation process is, consequently, impeded by the rejection exhibited by the legal system when it tries to incorporate a new rule from a foreign legal system.

One of the first writers to express this belief was Montesquieu. He contended that transplantation could not take place due to geographical, sociological, economic, cultural and political barriers.<sup>43</sup> He believed that law changes in response to these factors, which are external to the law itself, when that law is transferred from one legal system to another. He therefore believed that law is not independent, but must be considered in its particularity<sup>44</sup> and in light

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<sup>41</sup> T.T. Arvind, 'The Transplant Effect in Harmonisation' (2010) 59(1) *The International and Comparative Law Quarterly* 65-88.

<sup>42</sup> Maria Reyes, 'The challenges of legal transplants in a globalised context: A case study on 'working' examples' <[http://banrepcultural.org/sites/default/files/colf\\_reyesgaitan\\_mariapaula\\_tesis.pdf](http://banrepcultural.org/sites/default/files/colf_reyesgaitan_mariapaula_tesis.pdf)> accessed 23 November 2016

<sup>43</sup> Philip M. Nichols (1997) *The Viability of Transplanted Law: Kazakhstani Reception of a Transplanted Investment Code* <<https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1441&context=jil>> accessed 23 November 2016

<sup>44</sup> William Ewald 'Comparative Jurisprudence (11): The Logic of Legal Transplants' (1995) 43(4) *American Journal of Comparative Law* 489-510. Ewald also cited Savigny, Hegel, Marx, Jhering and Pound, who also embrace Montesquieu's approach and the particular factors he refers to

of these factors. Montesquieu's theory is later echoed by Seidman,<sup>45</sup> who also expressed a view against the effectiveness of legal transplants and also believed that every law is intrinsically influenced by the factors affecting a particular legal system.

Another like-minded writer is Pierre Legrand; however, Legrand limits the problem of the ineffectiveness of transplantation to only two factors: cultural and historical. He argued that transplantation of the law is simply not possible because every law is culturally and historically determined.<sup>46</sup> He believed that the transplantation problem arises in the interpretation and meaning ascribed to a particular rule by an interpreter which are distinctive and unique because the interpretation and the specific meaning depend on the particular cultural and historical factors influencing the interpreter. Accordingly, the interpretation and application of a rule largely depends on who and where the interpreter is.<sup>47</sup> As a result of this, Legrand believed that only meaningless forms of words can be displaced from one legal system to another because, as the original rule crosses boundaries, it will undergo significant changes in light of the cultural and historical factors that affect it. His conclusion, therefore, was that legal transplantation could never successfully take place.<sup>48</sup>

Other legal scholars, referred to as transferists, have expressed an opposing view and fully embrace and support the effectiveness of legal transplants and assert that legal transplantation

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<sup>45</sup> Helen Xanthaki, cited in Seidman R., *State and Law in the Developing Process: Problem Solving and Institutional Change in the Developing World* (Macmillan Publishers, Basingstoke, 1994) 44-46

<sup>46</sup> Pierre Legrand, 'The Impossibility of 'Legal Transplants' *Maastricht J. Eur. & Comp. L.*, (1997) 111-124

<sup>47</sup> Ibid.

<sup>48</sup> Ibid.

is not affected by any of the external factors identified by the culturalists. These transferists,<sup>49</sup> fully assent to the useful and optimistic implications of legal transplants in any legal system and do not believe that the effectiveness of legal transplantation is hindered by any of the factors identified by the culturalists.

One legal writer who considers legal transplants to be a necessity in every legal system is Alan Watson.<sup>50</sup> He positively emphasises the autonomous nature of the law<sup>51</sup> and is a firm believer that ‘most changes in most systems are borrowing’<sup>52</sup> without being affected by any external factor referred to above by the culturalists. He shows his approval for legal transplantation by providing three clear examples in his article entitled *From Legal Transplants to Legal Formants*. He begins by asserting that the political, social and religious factors do not affect the law when it is transplanted from one legal system to another. First, he shows the ineffectiveness of the political factor by referring to Calum Carmichael<sup>53</sup> and his analysis of the Ten Commandments. Watson believes that the Ten Commandments are reflected in subsequent histories without any particular connection to the time in which they were enacted and makes specific reference to the fifth Catholic Commandment to honour the parents and its inclusion in the Dutch civil code to support his argument. Watson also demonstrated in his article that the law may develop distinct from social realities. His second example is that of the

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<sup>49</sup> Gail Edwards, ‘Legal Transplants and Economics: The World Bank and Third World Economies in the 1980s – A Case Study of Jamaica, the Republic of Kenya and the Philippines’ <[http://sas-space.sas.ac.uk/349/1/Gail\\_Edwards\\_MA\\_Thesis.pdf](http://sas-space.sas.ac.uk/349/1/Gail_Edwards_MA_Thesis.pdf)> accessed 3 July 2017

<sup>50</sup> Alan Watson, ‘Legal Transplants and European Private Law’ (2006) <[http://www.alanwatson.org/legal\\_transplants.pdf](http://www.alanwatson.org/legal_transplants.pdf)> accessed 26 November 2016

<sup>51</sup> John W. Cairns, ‘Watson, Walton, and the History of Legal Transplants’ <<http://digitalcommons.law.uga.edu/cgi/viewcontent.cgi?article=1049&context=gjicl>> accessed 26 November 2016

<sup>52</sup> Alan Watson, ‘Comparative Law and Legal Change’ (1978) 37(2) *Cambridge Law Journal* 313-336

<sup>53</sup> Alan Watson, ‘From Legal Transplants to Legal Formants’ (1995) 43 (3) *The American Journal of Comparative Law* 469-476 made reference to *The Origins of Biblical Law: The Decalogues and the Book of the Covenant* (1992) of Calum Carmichael

creation and development of the Twelve Tables under Roman law, which is still consistently interpreted today, even though only limited provisions were enacted in the Twelve Tables. He, in fact, argues that, while the plebeians attempted to have the Twelve Tables enacted to have their rights protected, in reality it was a great defeat as the Twelve Tables only contained those parts of the law that the patricians were willing to share with the plebeians. Moreover, under Roman law, only senators could be judges. Watson, therefore, demonstrates that the interpretations given to these enacted laws continued to apply even thereafter, distinct from the social reality under which this law was first enacted. He, consequently, seeks to demonstrate that the interpretations given to the Twelve Tables seem to have continued to be adopted in subsequent laws even due to the fact that the Twelve Tables are considered as the foundation of any law. Using a third example, Watson also shows that the religious factor is not reflected in the enactment and interpretation of the law. He refers to a general example chosen from the rabbinic law as set out in the Mishnah and Talmud, which did not provide a specific definition of work, and insists that the definition of work has changed throughout the ages and depends mainly on the distinct legal system that regulates that work. In addition to the above, Watson goes even further in his acceptance of the effectiveness of legal transplantation by reiterating that not only rules, but also institutions, concepts and structures can be transplanted.<sup>54</sup>

Ajani came to endorse Watson's approach and aimed to support his theory by referring to the blurred distinction that exists today between the civil and the common legal systems. He mentions two specific examples to sustain his argument as arising under business and tort law,

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<sup>54</sup> Kyselova (n 36)

wherein the Anglo-American principles are increasingly influencing continental scholars and judges.<sup>55</sup>

Nevertheless, the majority of writers fall in the middle of the spectrum, an approach that seems to have been endorsed by the Maltese legal system in its regulation of the fiduciary duty of directors, as we will see throughout this thesis. These scholars readily accept the importance of legal transplantation, but also believe that its effectiveness is subject to the factors referred to above with the result that legal transplantation will be applied only within the limitations imposed by the factors delineated above. For this reason, one of them, Teubner,<sup>56</sup> prefers to refer to legal transplantation as a ‘legal irritant’ because in his opinion, while a transplant seems to imply the movement of a rule that maintains its original meaning, an irritant refers to a particular rule that can change its meaning in alignment with any external influences.<sup>57</sup>

The regulation of the fiduciary duty of directors in Malta can be easily understood to fall in the middle of the spectrum because the effectiveness of legal transplantation has shaped the backbone of the regulation of the fiduciary duty of directors in the Maltese legal system in light of the acceptance or denial of the factors identified above. This study will present the ways in which the efficiency of the legal transplantation has affected the regulation of the fiduciary duty through the factors that have led to changes exhibited by Maltese statute law and judicial practice. It will therefore consider whether, and to what extent, historical, societal, cultural, political prestige and economic factors, together with familiarity with the law, have influenced

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<sup>55</sup> Gianmaria Ajani, ‘By Chance and Prestige: Legal Transplants in Russia and Eastern Europe’ (1995) 43 *American Journal of Comparative Law* 93

<sup>56</sup> Gunther Teubner, ‘Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Differences’ (1998) *Modern Law Review* 11-32

<sup>57</sup> *Ibid.*

legal development in Malta with regard to the regulation of the fiduciary duty of directors, and conceptualise the reform of the duty as a particular case of legal transplantation.

From a statutory point of view, the main factor that may have facilitated the effectiveness of legal transplantation in the Maltese context is the historical barrier, which is tied with the societal and cultural factors. In this regard, it is demonstrated that historical events led the Maltese legal system to be subjugated first to the Italian influence and later on to English authority. Although the Italian influence affected the Maltese approach until the 1940s, the English legal system has ultimately shaped the approach in the way it is currently understood in today's business context, an influence that was solidified through the enactment of Article 136 A of the Maltese Companies Act 1995 in 2003. Investigation of the historical factor reveals that Maltese lawmakers throughout the years have taken a certain degree of comfort in looking at a particular foreign legal system, be it Italian or English, following the customs ruling the Maltese islands at any given time. This distinct type of legal transplantation is referred to as 'imposition' by Graziadei,<sup>58</sup> who believes that the imposition of a legal transplant is the result of military conquest or expansion such is the case in Malta, which has been conquered by various foreign powers throughout the ages, each of whom have left their unique marks on the Maltese legal system. To illustrate this concept of imposition, Graziadei provides four examples: the extension of German law to Austria after the Anschluss of 1938; the sovietisation of the law in Central and Eastern Europe after World War II; the growth of colonial empires round the world; and the spread of Islamic Law during the Middle Ages as a result of military

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<sup>58</sup> Michele Graziadei, 'Comparative Law as the Study of Transplants and Receptions' in *The Oxford Handbook of Comparative Law* (1st edn, Oxford University Press 2006). Vide also M. Cohn., Legal Transplant Chronicles: The Evolution of Unreasonableness and Proportionality Review of the Administration in the United Kingdom, *American Journal of Comparative Law* [2010]

expansion by Islamic rulers. Pistor et al.<sup>59</sup> share the same view and provide two further examples: the reception of Roman law in Europe, and the European influence that has largely been imposed through war.

The historical factor can become evident through the social and cultural approach. The terms ‘social’ and ‘culture’ encompass the speech, knowledge, beliefs, customs, arts, technologies, ideals and rules that govern a particular legal system,<sup>60</sup> but whereas the social factor largely refers to the change exhibited by the whole society, a cultural change only refers to a revolution exhibited by a group of society. Nonetheless, both cover the language, especially the legal language, which governs the everyday relationships among people who live in the same society. Cohn suggests that the precise cultural contributions of the legal system that is transplanting the law provides for the complex evolutionary process of the law.<sup>61</sup> In fact, it is observed that such cultural factor has influenced the regulation of the fiduciary duty of directors in Malta, as laws were enacted in Malta in Italian since this language was considered important at the time: Italian continued to be unequivocally used by the legislators until the 1940s, at which point the English influence began to be accepted in the Maltese culture. Accordingly, English and the English legal system were subsequently used when drafting the law.

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<sup>59</sup> Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, ‘The Transplant Effect’ (2003) 51(1) *American Journal of Comparative Law* 163-203

<sup>60</sup> Laura-Cristiana Spataru-Negura, Exporting Law or the Use of Legal Transplants, who made reference to A. L. Kroeber, *Anthropology: race, language, culture, psychology, prehistory*, 253 (rev. Ed. 1948); see also Clyde Kluckhohn, *Culture and behaviour*, 73, (Richard Kluckhohn ed., 1962) and Philip M. Nichols, The viability of transplanted law: Kazakhstani reception of a transplanted foreign investment code, *U. Pa. J. Int’l Econ. L.*, vol. 18:4, 1997, 1237

<sup>61</sup> Cohn (n 58)

This analysis of the historical factor, together with the societal and cultural factors, shows that legislators enact laws in accordance with their familiarity with the law of that foreign legal system. Jan Smits also states that ‘the success of legal transplants should take into account the extent to which law is tied to its social, economic and cultural environment’.<sup>62</sup> These three factors have thus shaped and structured the law pertaining to the statutory fiduciary duty of directors in Malta in a unique way.

However, judicial practice in Malta and its interpretation of the fiduciary duty of directors must be considered as a significant factor on its own and distinct from the three factors discussed above. The Maltese Courts are a major factor in themselves, and this has given rise to other factors that have led to the effectiveness of legal transplantation in the Maltese legal system. Smits also believes that the Courts are an influential factor that can grant the successful applicability of legal transplantation in a particular legal system.<sup>63</sup> Watson similarly<sup>64</sup> believes that Courts may exert their own pressures on the effectiveness of legal transplantation: he makes specific reference to the influence exerted by Roman jurists, the English judges of the Middle Ages and thereafter, and to Continental law professors to support his theory. Hupper<sup>65</sup> goes even further in emphasising the extent of this influence that may be exerted by Courts to give full effectiveness to legal transplantation by making specific reference to Wolfgang Wiegand’s article *The Reception of American Law in Europe*,<sup>66</sup> which studies the impact on the Swiss legal system of Swiss students who pursued their studies in the United States of

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<sup>62</sup> Jan Smits, ‘On Successful Legal Transplants in a Future Ius Commune Europaeum’ *Maastricht University Faculty of Law - Maastricht European Private Law Institute (M-EPLI)* (2008)

<sup>63</sup> *Ibid.*

<sup>64</sup> Watson, *From Legal Transplants to Legal Formants* (n 51)

<sup>65</sup> Gail J. Hupper, ‘The Academic Doctorate in Law: Vehicle for Legal Transplants?’ (2008) 58(3) *Journal of Legal Education*, 413-454

<sup>66</sup> Wolfgang Wiegand, ‘The Reception of American Law in Europe’ (1991) 39 *American Journal of Comparative Law* 229

America and who bring their own influences with them and incorporate them into their work in the Swiss Courts. With respect to the Maltese legal system, the Maltese Courts are considered to be a factor in their own right because they were highly influenced by the English legal system long before such influence was wholly incorporated into statute law (vide Chapters 3 and 5). This is because they tend to apply economic and prestige factors rather than the historical, societal and cultural factors tied up with the familiarity of the law. As a result, the Courts are more interested in the benefits they can reap from the law they apply in their judgments, rather than its historical, societal or cultural ties.

The judicial factor is also very much tied to the prestige factor, which has been fiercely debated by legal scholars, and is referred to by Miller as the ‘legitimacy-generating transplant’.<sup>67</sup> On this subject, Miller refers to Alan Watson, who in his opinion is the only author to have delved into the notion of why the prestige of a foreign model might motivate a legislator or a judge in another country to choose to be guided by that particular legal system. In fact, Watson asserts that the prestige of the foreign model is linked with the authority it provides for legislators and especially for the judiciary, which will in turn enhance and solidify the good reputation enjoyed by the Courts.<sup>68</sup> The prestige factor is also discussed at length by Sacco, who provides three relevant examples.<sup>69</sup> He refers to the prestige carried by Roman law across Europe, to the prestige presented by the French Civil Code 1804 and the German doctrine beyond the frontiers of the civil law, and lastly to the unique prestige presented by the French and English rules and

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<sup>67</sup> Miller also makes reference to Ajani (n 55); deLisle, *Lex Americana*: United States Legal Assistance, American Legal Models, and Legal Change in the Post-Communist World and Beyond’ (1999) 20 *U. Pa. J. nt’l Econ. L.* 170; Sacco, ‘Legal Formants: A Dynamic Approach to Comparative Law (Installment II of II)’, (1991) 39 *American Journal of Comparative Law* 343, 398-99; Alan Watson, ‘Aspects of Reception Law’, 44 *American Journal of Comparative Law* 346, 350-51

<sup>68</sup> Watson, *Aspects of Reception Law* (n 67)

<sup>69</sup> Sacco (n 67)

institutions that penetrated irreversibly into Africa. Esin Orucu<sup>70</sup> is also a firm believer in the notion that prestige positively triggers the effectiveness of legal transplantation. He believes that although the original meaning of the rule might change when that particular rule is transplanted, the prestige that that particular rule and its original legal system enjoy will not be in any manner undermined; as a consequence, that particular rule will be unquestionably accepted under the new legal system. By way of example, Orucu also makes reference to Alan Watson's approach to the example presented in relation to the influence exerted by Roman law, whereby parts of such law were used in Scotland and South Africa during the 20<sup>th</sup> century. Accordingly, for the reasons outlined herein, the influence of this prestige factor in the Maltese legal system cannot be underestimated, as the majority of the judiciary are very much aware that such prestige will eventually lead to more respect for the judiciary and more authority; yet, it must also be asserted that they have never openly admitted this fact.

The economic factor is likewise as important as the prestige factor, and is looked upon by the majority of the Maltese judiciary with a degree of significance that equals that of prestige, even if, again, none of the Maltese judiciary has ever openly discussed the significance of this factor. This economic factor is discussed at length by Pistor et al.,<sup>71</sup> who conclude that weaknesses in corporate governance result in economic deficiency and go on to highlight the importance of the economic factor in every legal system. In this regard, they conclude that enacting the right law will eventually boost the development of financial markets, but also suggest that these

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<sup>70</sup> Esin Orucu, 'Critical Comparative Law: Considering Paradoxes for Legal Systems in Transition' (2000) 4 *Electronic J of Comp L*, <<http://www.ejcl.org/41/art41-1.html>> accessed 30 July 2015

<sup>71</sup> Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp and Mark D. West, 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries', (2003) 18(1) *The World Bank Research Observer* 89-112 <<http://siteresources.worldbank.org/INTLAWJUSTINST/Resources/pistor-transplants.pdf>> accessed 10 August 2016

hasty conclusions should be treated with caution. Indeed, if a domestic law imposes a higher cost than that imposed by a more favourable jurisdiction; the threat of migration to the more favourable jurisdiction will arise.<sup>72</sup> This economic importance and the enactment of the right law is thus particularly important for small countries like Malta, which are heavily dependent on international trade and must therefore attract firms from other jurisdictions and multinational corporations to secure increased investment, a higher demand for labour and more tax revenue.<sup>73</sup> The economic factor therefore influences a country's financial development, which clearly shows its importance. This positive connection between the economic factor and growth in the financial market was affirmed by the British Prime Minister William Gladstone, who stressed the importance of having a strong financial background and development for economic growth in 1858 when he stated that 'Finance is, as it were, the stomach of the country, from which all the other organs take their tone'.<sup>74</sup> However, the constructive link between the economic and the financial sectors of a legal system was first articulated from an economist point of view by Joseph Schumpeter in 1911. He devised the theory of creative destruction, which holds that a strong economy needs to allocate resources efficiently and use savings systemically.<sup>75</sup> This linkage was again widely discussed in the 1980s, at which time Dornbusch and Reynoso went one step further and asserted that financial growth is based on the government's incentive to invest, that savings must be available, that such savings should be used to attract the most lucrative investment opportunities,<sup>76</sup> and that

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<sup>72</sup> Garoupa and Ogus (n 38)

<sup>73</sup> Ibid.

<sup>74</sup> Willem F. Duisenberg, 'The role of financial markets for economic growth', European Central Bank (2001) <<https://www.ecb.europa.eu/press/key/date/2001/html/sp010531.en.html?>> accessed 10 August 2018

<sup>75</sup> Yongseok Shin, 'Financial Markets: An Engine for Economic Growth', Federal Reserve Bank of St Louis (2013) <<https://www.stlouisfed.org/publications/regional-economist/july-2013/financial-markets--an-engine-for-economic-growth>> accessed 5 August 2018 and Adalbert Winkler, 'The Dual Role of Financial Markets in Economic Development: Engine of Growth and Source of Instability', (1998) <[https://www.wiwi.uni-wuerzburg.de/fileadmin/12010100/Publikationen/Adalbert\\_Winkler/WP\\_18.pdf](https://www.wiwi.uni-wuerzburg.de/fileadmin/12010100/Publikationen/Adalbert_Winkler/WP_18.pdf)> accessed 5 August 2018

<sup>76</sup> Rudiger Dornbusch and Alejandro Reynoso, 'Financial Factors in Economic Development', National Bureau of Economic Research (1989) <<http://www.nber.org/papers/w2889.pdf>> accessed 5 August 2018

‘poor finance leads to inflation and external bottlenecks and they in turn bring about restrictive macroeconomic policies and these slow down growth and investment’.<sup>77</sup> In view of this, it can accordingly be asserted that economic development, democratisation and globalisation<sup>78</sup> have caused a sharp increase in the number of legal transplants in today’s business context. . This economic factor, in fact, has influenced the path taken by Maltese legal system, which through the majority of the Maltese judiciary, was influenced by the strong Italian economy during the 1800s,<sup>79</sup> but was inclined to look at the developments taking place in the English legal system due to the strong economy that the English legal system was building. This British influence led to the formation of the first commercial banks in Malta in 1806; one of these banks was named the Anglo-Maltese Bank, and foreign trade in Malta flourished.<sup>80</sup> Throughout 1813 and 1814, however, the Maltese economy was struck by disaster following the introduction of custom controls; worse yet, quarantine regulations were imposed by foreign governments against Maltese ships because of the plague.<sup>81</sup> Despite this, the English colony was again able to rebuild the Maltese economy after the Crimean War, which led to investment in the colony’s military and naval establishments, and local business in Malta flourished once again due to the influx of soldiers and sailors.<sup>82</sup> The economy in the Maltese islands continued to be robust and grew even stronger during World War II,<sup>83</sup> during which time there were British naval bases

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<sup>77</sup> Ibid.

<sup>78</sup> Jonathan M. Miller, ‘A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process’, in *American Journal of Comparative Law*, Vol. 51, No. 4 (Autumn, 2003), 839-885

<sup>79</sup> Economic Theories, Italy Economic History, <<http://www.economictheories.org/2008/11/italy-economic-history.html>> accessed 17 June 2016 and Gianni Toniolo, ‘Italy’s Economic Growth: An Overview’ referred in *The Oxford Handbook of the Italian Economy since 1861*,

Oxford University Press 2012 <<http://www.dis.uniroma1.it/~fsr/Toniolo2012.pdf>> accessed 17 June 2016

<sup>80</sup> Maltese History, ‘19<sup>th</sup> & 20<sup>th</sup> Century Social & Economic History’ <[https://storjaweb.files.wordpress.com/2016/10/unit\\_j\\_economic\\_development\\_1800\\_todate\\_13p.pdf](https://storjaweb.files.wordpress.com/2016/10/unit_j_economic_development_1800_todate_13p.pdf)> accessed 18 June 2018

<sup>81</sup> Ibid.

<sup>82</sup> Ibid.

<sup>83</sup> Ibid.

located in Malta, a situation that also led to important infrastructural changes.<sup>84</sup> After World War II, Malta suffered several economic blows, particularly as a result of the United Kingdom's decision to decrease and then discontinue its military operations here. Nonetheless, the Maltese people were able to strengthen Malta's shipping and agricultural industries and also to attract multinational companies to the country's shores<sup>85</sup> to again build a strong economy. However, despite the British having left, the Maltese economy continued (and still continues) to look to the English legal system due to its demonstrated ability to build a strong economy over time. London became the largest financial centre in the world,<sup>86</sup> something that reflects the good working order of the English legal system. In fact, in this regard, some legal economists trace the superiority of common law to the Posnerian hypothesis created by Judge Posner, who contends that the common law provides a more coherent system, which leads to a more efficient behaviour, such as the reduction of transaction costs to favour market transactions.<sup>87</sup> This Maltese approach is further reflected in the theory presented by La Porta et al., who show that countries incorporating a common legal system enjoy better financial markets than countries incorporating the civil system.<sup>88</sup>

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<sup>84</sup> Lino Briguglio and Gordon Cordina, 'The Economic Vulnerability and Potential for Adaptation of the Maltese Islands to Climate Change' <[https://www.um.edu.mt/\\_\\_data/assets/pdf\\_file/0007/284938/PaperCordinaBriguglioMalta\\_EconomicaspectsClimatechangeandadaptation.pdf](https://www.um.edu.mt/__data/assets/pdf_file/0007/284938/PaperCordinaBriguglioMalta_EconomicaspectsClimatechangeandadaptation.pdf)> accessed 10 August 2018 and Noel Rapa, 'The effects of Brexit on the Maltese economy' Central Bank of Malta (2017) <<https://www.centralbankmalta.org/file.aspx?f=61604>> accessed 10 September 2018

<sup>85</sup> Maltese History (n 80)

<sup>86</sup> Tim Wallace, (2015) Rule Britannia: London overtakes New York as the world's best financial centre, <<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11884783/Rule-Britannia-London-overtakes-New-York-as-the-worlds-best-financial-centre.html>> accessed 26 November 2016

<sup>87</sup> Nuno Garoupa and Carlos Gomez Liguerra, 'The Efficiency of the Common Law: The Puzzle of Mixed Legal Families' 29 Wis. Int'l L.J. 671 (2012) <<https://scholarship.law.tamu.edu/cgi/viewcontent.cgi?article=1478&context=facscholar>> accessed 10 August 2018

<sup>88</sup> Pistor, Keinan, Kleinheisterkamp and West (n 71); Garoupa and Liguerra (n 87); Shin (n 75); Kensie Kim, 'Mixed Systems in Legal Origins Analysis' *Southern California Law Review* 83 (963) <[https://weblaw.usc.edu/assets/docs/contribute/83\\_3KimforWebsite.pdf](https://weblaw.usc.edu/assets/docs/contribute/83_3KimforWebsite.pdf)> accessed 10 August 2018

In view of the above analysis, this examination of the economic and prestige factors suggests that the prestige factor is very much tied to the economic factor and cannot be separated from it. Although the Maltese Courts have never made specific reference to the link between the economic and prestige factors, prestige shall always be considered due to its economic impact, a point also emphasised by various foreign legal scholars. DeLisle asserts that prestige comes from perceptions of efficacy and global importance,<sup>89</sup> and Ugo Mattei argues that prestige is directly linked to economic efficacy,<sup>90</sup> although he fails to offer strong empirical evidence to support this argument. Michele Graziadei also makes specific reference to the importance of linking prestige and economic significance together under one rule.<sup>91</sup> The prestige and economic factors are also looked upon as a whole by Cuniberti, who links them through the good reputation that the Courts strive to enjoy. The judiciary is therefore attentive to the question of what foreign legal system they should apply, because as Cuniberti<sup>92</sup> asserts, a good judicial reputation brings with it a certain degree of prestige and better economic environment, which is in return, therefore, essential for legal transplantation. To further prove his theory, he makes explicit reference to Garoupa and Ginsburg, who assert that judges care very much about their reputation and have an incentive to enhance it, which is only possible through the growth of social and economic assets.<sup>93</sup> Cuniberti goes on to admit that enhancing the judiciary's collective reputation may also increase the trust of foreign parties in that particular legal system, which in turn leads to order. He specifically refers to the French legal system as a case in point.<sup>94</sup> The benefit reaped from the economic and prestige factors can be referred to as 'the

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<sup>89</sup> Miller (n 78)

<sup>90</sup> Miller makes reference to Mattei, *Efficiency in Legal Transplants: An Essay in Comparative Law and Economic*, 14 *Int'l Rev. L. & Econ.* 3, 8 (1994)

<sup>91</sup> Graziadei (n 58)

<sup>92</sup> Gilles Cuniberti, 'Enhancing Judicial Reputation through Legal Transplants – Estoppel Travels to France' (2012) 60 (2) *American Journal of Comparative Law* 383.

<sup>93</sup> Nuno Garoupa & Tom Ginsburg., *Reputation, Information and the Organisation of the Judiciary*, available at <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1523954](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1523954)> accessed 10 August 2015

<sup>94</sup> Cuniberti (n 92). Cuniberti made reference to Sacco, Graziadei and Ugo Mattei

entrepreneurial transplant',<sup>95</sup> as Miller explains. Miller also makes reference to Dezelay and Garth,<sup>96</sup> who originally proposed this specific type of transplantation. This principle focuses on individuals and groups who reap benefits from investing their energy in learning and encouraging the local adoption of a foreign legal model. Miller also argues that this type of transplant must lead to some type of payoff for the receiving jurisdiction if they are to readily accept a foreign rule and adapt it as its own, although this achievement does not need to result in a pecuniary gain. In this respect, reference to Dezelay and Garth's conclusion seems adequate who although they make precise reference to the political or economic benefits of their investment, they also assert that reputation is also likewise important and should be taken into consideration.<sup>97</sup>

This judicial influence, which is also subject to the economic and prestige factors, together with the historical, societal and cultural factors are present in every legal system and all factors are ultimately accommodated through the political influence. While there may be instances in which the political class takes time to accommodate these judicial influences, the political actors ultimately look at the judiciary's decisions and change the law to combine the statute law and judicial law into one complete set of laws.<sup>98</sup> This political approach is ultimately very accommodating of the judiciary because the political class of any jurisdiction also forms part of the elite of a particular society, much like judges, and groups of this kind seem to prefer to give more consideration to economic and prestige factors rather than the historical, societal and

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<sup>95</sup> Miller (n 78)

<sup>96</sup> Miller (n 78) makes reference to Yves Dezelay & Bryant G. Garth's work, *The Internationalisation of Palace Wars: Lawyers, Economists, and the Contest to Transform Latin American States* (2002) and to Koh, *Bringing International Law Home*, 35 *Hous. Rev.* 623 (1998) in Yale Law School Legal Scholarship Repository. See also Finnemore & Sikkink, *International Norm Dynamics and Political Change*, 52 *Int'l Org.* 887, 893, 896-97 (1998)

<sup>97</sup> Miller (n 78)

<sup>98</sup> By way of example, this situation happened in Malta in this particular case

cultural factors, together with familiarity with the law, even if not readily stated so. Through their decisions, politicians can exert authority over the legal system, and their decisions are highly esteemed without any further revision as much as the Court judgments.<sup>99</sup> This political factor can be succinctly described as the externally-dictated transplant, as proposed by Miller.<sup>100</sup> This political factor is highly influential in the Maltese legal system, and it is shown that the English legal system has exerted strong influence over the Maltese legal system. At first glance, it might seem that the Italian influences could not have had so much impact on Malta, as it was only in 1921 that the first self-government was instituted in the country, but the Italian influences have been very strong until the 1940s as will be observed in Chapter 3. This first Maltese government shared political power with the British government until 1964, the year Malta gained independence.<sup>101</sup> For this reason, however, the political approach that has arisen in Malta strongly resembles that of the United Kingdom,<sup>102</sup> with two main political parties, the Conservative party and the Labour party. The campaigning process of each party and the ways in which ministers and shadow ministers are chosen is also very similar. Although the political factor exerts a great deal of positive influence over the concept of legal transplantation, Kahn-Freund, who readily admits the importance of the political factor, believes that it can function as a hindrance to the smooth functioning of legal transplantation. He makes explicit reference to the English legal system to substantiate his theory. Kahn-Freund readily accepted the importance of legal transplantation, and was indeed conscious that the British legislation 'has become open to foreign influences'.<sup>103</sup> In fact, Kahn-Freund believed

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<sup>99</sup> Watson, *From Legal Transplants to Legal Formants* (n 51)

<sup>100</sup> Miller (n 78)

<sup>101</sup> Joseph M. Pirota, Enrico Mizzi's Political Integrity: Fact or Fiction? <[http://josephpirota.com/main/Publications\\_files/ENRICO%20MIZZI'S%20POLITICAL%20INTEGRITY.pdf](http://josephpirota.com/main/Publications_files/ENRICO%20MIZZI'S%20POLITICAL%20INTEGRITY.pdf)> accessed 20 August 2015. This article points out that, although the British political influence was paving the way, the country's Italian heritage could not be ignored by many Maltese people

<sup>102</sup> A. Williams. *UK Government & Politics*, 2nd edn., (1998) United Kingdom: Heinemann Educational Publishers

<sup>103</sup> Cairns (n 51)

that Montesquieu's geographical, economic, social and cultural factors had lost ground over the two hundred years since Montesquieu's speech. He was also a firm believer in the idea that industrialisation, urbanisation and the development of communications have greatly reduced the environmental obstacles to legal transplantation. In his view, effective transplantation in the United Kingdom took place due to both international unification and the entry of the United Kingdom into the European Communities, and that the often discussed historical, geographical, economic, social and cultural factors have lost ground following the creation of this international unification among different countries. Kahn-Freund argues that Montesquieu could not have envisaged the developments that eventually took place that evidently contributed to the change in the legal transplantation approach since Montesquieu lived in another period. However, at the same time, Kahn-Freund admits that the political factor referred to by Montesquieu had acquired significant importance in the effectiveness of transplantation, which hinders the undisturbed process of legal transplantation.<sup>104</sup> Consequently, in his opinion, knowledge of the political background of the donor country can help facilitate better understanding and interpretation of that rule in the recipient country.<sup>105</sup>

Considering the above, it seems appropriate to appreciate that legal transplantation in current Western jurisdictions, as in the case of the Maltese legal system, tends to take place among countries with similar legal systems, language and legal traditions, mainly as a means to ensure harmony.<sup>106</sup> Indeed, Ogus<sup>107</sup> argues that legal transplantation tends to occur when the

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<sup>104</sup> Ibid. Cairns made reference to Kahn-Freund's theory

<sup>105</sup> Kyselova (n 36)

<sup>106</sup> Helen Xanthaki, *The International and Comparative Law Quarterly*, Vol. 57, No. 3 (Jul., 2008), 659-673

<sup>107</sup> Garoupa and Ogus (n 40)

transplanted law leads to only a very minor difference between the jurisdictions. Xanthaki<sup>108</sup> also supports the view that only similar jurisdictions can take from each other and supports such theory by also referring to other various scholars. However, the unique legal transplantation process in Malta with respect to the regulation of the directors' fiduciary duty has taken place subject to the significant factors described above. It can therefore be concluded that, as Legrand says, only meaningless words can travel, and these words go on to take the distinctive shape of the legal system in question.<sup>109</sup> This assertion is important because the statutory provisions enacted in Malta do not provide for an exact interpretation under the Italian and English legal systems (vide Chapter 4) and specific interpretations have been adopted by most of the Maltese judiciary in line with the Maltese business community and its traditions (vide Chapter 5).

These traits of the Maltese legal system are also interesting in light of other mannerisms shown by other mixed legal systems when faced with the various factors mentioned above. Although a comprehensive examination would require a thorough study of its own, it seems that other mixed legal systems are also a product of legal transplantation. Orucu argues that every mixed legal system is a combination of different laws. He provides a range of examples to support his point, referring to Louisiana, Quebec, Algeria, Hong Kong and India, amongst others.<sup>110</sup> He observes that Louisiana and Quebec have a mix of common and civil legal systems, much like

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<sup>108</sup> Xanthaki (n 71). Reference was made to: Gutteridge H, *Comparative Law* (CUP, Cambridge, 1949) 73; Buckland W.W and McNair A.D., *Roman Law and Common Law* (CUP, Cambridge, 1936). Vide also Miller, who asserts that 'Efficiency depends on local characteristics', and Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, 'The Transplant Effect' (2003) 51(1) *American Journal of Comparative Law* 163-203, who also believe that 'legal transplants may work, if they are adapted, or if the population is already familiar with the basic principles of these laws'

<sup>109</sup> Pierre Legrand, 'The Impossibility of 'Legal Transplants'', 4 *Maastricht J. Eur. & Comp. L.* 111 1997 <<http://www.pierre-legrand.com/transplants.pdf>> accessed 10 July 2015

<sup>110</sup> Esin Orucu, 'What is a Mixed Legal System: Exclusion or Expansion?' *Electronic Journal of Comparative Law*, vol. 12.1 (May 2008) <<https://www.ejcl.org/121/art121-15.pdf>> accessed 15 July 2018

the Maltese system. By contrast, the Algerian legal system contains traits of civil law, religious law and tribal law. Hong Kong's legal system is more inclined towards the incorporation of Chinese law and civil law, while the Indian legal system embodies common law, religious law and customary law. As with Malta, each mixed legal system seems to readily consent to the influences and positive effectiveness of legal transplantation through the various factors mentioned above. Louisiana and Quebec were both French colonies and are both influenced by the same legal systems, thus illustrating the applicability of the historical, societal and cultural factors. Nevertheless, Louisiana legal system has, over time, developed its own laws and departed from the French influence to a significant extent,<sup>111</sup> which demonstrates that the legislators have decided to depart from the historical, societal and cultural factors and to take other factors into consideration. Hong Kong also illustrates the effectiveness of the concept of legal transplantation through the various factors discussed above. Although part of China, Hong Kong's legal system is subject to the economic and financial impact in its application of laws, especially in company law, while Chinese laws tend to be more complicated and more difficult to apply on a global level,<sup>112</sup> with the result that the economic factor does not seem to be at the core for legislators in China.

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<sup>111</sup> Jan Smits, *The Making of European Private Law*, (1<sup>st</sup> edn, Intersentia 2002) pp. 119

<sup>112</sup> Matt Slater, *7 Key Differences between Hong Kong & China registered companies* (2017) <<http://therightsocialmedia.novertur.com/international-trade-2/hong-kong-china-registered-companies/>> accessed 10 August 2018

## **Chapter 2. The sources of the Italian, English, European and international systems**

### **2.1 Introduction**

The purpose of this chapter is to analyse the origin and evolution of trust law, agency law, fiduciary law and mandate law, all of which have regulated the fiduciary duty of directors under two different legal systems: the Italian and English systems. This examination is important, as these two systems are the backbone of the Maltese statutory legal system in this particular field. Accordingly, assessing the foundations of the different legal regimes that have influenced the Italian and English legal systems will illustrate how the Maltese legal system, as analysed in detail in Chapter 3, was influenced.

It also examines the lack of regulation, influences and challenges presented by the European Union and the different international organisations that Malta forms part of on the regulation of the fiduciary duty of directors.

## 2.2 The influence of Roman law on the evolution of the regulation of the fiduciary duty of directors

### 2.2.1 Introduction

Roman law is considered to be the backbone of both the civil<sup>113</sup> and common<sup>114</sup> legal systems. It is consequently noted that both legal systems trace their history back to Roman law with respect to the regulation of the fiduciary duty of directors, as regulated by trust law, agency law and fiduciary law under the English legal system on the one hand, and mandate law and fiduciary law under the Italian legal system on the other. Accordingly, although the Italian legal system is categorised as a civil legal system and is undoubtedly based on Roman law while the English legal system is based on equity and common law and may therefore not be readily linked to the Roman law influence,<sup>115</sup> these different regimes that have regulated the fiduciary duty of directors all trace their history back to Roman law, as will be illustrated below.

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<sup>113</sup> George Mousourakis, *Roman Law and the Origins of the Civil Law Tradition*, (1<sup>st</sup> edn, Springer International Publishing Switzerland 2015) pp. 296

<sup>114</sup> Edward D. Re, 'The Roman Contribution to the Common Law', 29 *Fordham L. Rev.* 447 (1961) <<https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1673&context=flr>> accessed 10 July 2018. He refers to many writers who assert that Roman law was the beginning of the civilisation that gave rise to the English common legal system. They reached such conclusion because the Romans conquered England, which therefore led to the influence of Roman law on the English legal system

<sup>115</sup> Peter Stein, 'The influence of Roman Law on Common Law' <<https://openaccess.leidenuniv.nl/bitstream/handle/1887/36630/240.pdf?sequence=1>> accessed 16 June 2016. Other legal writers who believe that the English legal system is influenced by Roman law include William L. Burdick (*The principles of Roman Law and their relation to modern law* (1<sup>st</sup> edn., The Lawbook Exchange Ltd. 2004)), who also made reference to Blackstone, Lord Holt, Welsby, Lord Campbell, Holdsworth and King Henry II. Ulrike Malmendier made reference to Knutel, who in turn also made reference to Blackstone; vide Ulrike Malmendier (Berkeley), 'Roman Law and the Law-And-Finance Debate' <[http://eml.berkeley.edu/~ulrike/Papers/version\\_25\\_06\\_09\\_accept.pdf](http://eml.berkeley.edu/~ulrike/Papers/version_25_06_09_accept.pdf)> accessed 20 December 2014. However, other legal writers do not contend that the English legal system is based on Roman Law; these include William Wirt Howe and William Stubbs, who are also mentioned by William L. Burdick in his book (see above). William L. Burdick also refers to Sir William Jones, who readily accepts that all law is based on Roman law except for laws of feudal origin. All of these writers were referring to the common law in general and not to the particular regimes that regulate the fiduciary duty of directors

Although Roman law gave rise to the legal regimes that eventually came to regulate the fiduciary duty of directors under these two legal systems, each of these regimes was not primarily created to regulate the fiduciary duty of directors; rather, each continued to evolve distinctively under the Italian and English legal systems and to be eventually applied to the regulation of the fiduciary duty of directors under the customs of each unique legal system.

### 2.2.2 Trust law

Trust law was the first body of law to be created under Roman law with respect to the regulation of relationships between persons,<sup>116</sup> yet it was not referred to as trust law, but rather as *fideicommissum*, a term derived from the Latin word *fides*, meaning faith.<sup>117</sup> It was never explicitly used to regulate the fiduciary duty of directors, and was the first form of the Roman *societas*, which was only used in the family context<sup>118</sup> for inheritance purposes. *Fideicommissum* was not intended to regulate the fiduciary duty of directors because it was limited to certain specific relationships and could only arise in cases in which one person was still alive to execute the will of the dead person. Therefore, at the beginning, *fideicommissum* could not find ground in the regulation of the fiduciary duty of directors because directors are always a live legal or natural person, and *fideicommissum* was applied only in cases of gifts given by the testator to another person after his death under codicils expressed by the testator. Any person could receive under *fideicommissum*, even unmarried persons who were otherwise

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<sup>116</sup> Trust Arte, 'History' <<http://trustarte.com/pages/history.html>> accessed 3 January 2015. It notes that 'Earlier trust agreements dated to 200 BC were called *fideicommissum*, and popular in Roman law for centuries'

<sup>117</sup> Your Dictionary, *fideicommissum* <<http://www.yourdictionary.com/fideicommissum>> accessed 10 April 2017

<sup>118</sup> Istvn Sandor, 'The Emergence and Development of Limited Liability in the field of Company Law' (Ph.D. Associate Professor, Head of Department of Civil and Roman Law) <[http://www.kre.hu/portal/doc/sic/2009/sic4\\_16\\_sandor.pdf](http://www.kre.hu/portal/doc/sic/2009/sic4_16_sandor.pdf)> accessed 2 June 2015; William Hamilton Bryson, 'The Roman Law of Trusts' (1990) 34 *Am. J. Legal Hist.* 201. See also R. W. Lee, *The Elements of Roman Law* (7<sup>th</sup> edn, Sweet and Maxwell 2004)

excluded as heirs or legatees, and childless persons.<sup>119</sup> Codicils were originally informal letters requesting friends to ensure that certain gifts were received by the person chosen by the testator after his death. Consequently, codicils were often made by testators after a will was drawn up<sup>120</sup> to impose a trust on the heir instituted in the will, but they could also be made by persons who had left no will and would place such a trust or trusts upon the intestate successor or successors. However, codicils could not appoint nor disinherit an heir. They could be of four types: those confirmed by a subsequent will, those confirmed by a previous will, those resulting from a clause in a will, or those made by an intestate.<sup>121</sup>

However, at the same time, it is also noted that *fideicommissum* is very much similar to the relationship between directors and companies because, due to its nature, a relationship arises based on the honour and faith between those who were charged with its execution<sup>122</sup> and those persons who used to appoint these persons. The appointed person had to discharge the fiduciary duty to the person that had entrusted them with the execution. In this regard, therefore, trust was very much inherent in these relationships, because a person needed to totally entrust another person with his will, who was required to ultimately act for the benefit of a third person.

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<sup>119</sup> Burdick (n 115) 621

<sup>120</sup>Wiley Online Library, 'Fideicommissum' <<http://onlinelibrary.wiley.com/doi/10.1002/9781444338386.wbeah13102/abstract>> accessed 5 January 2015

<sup>121</sup> Burdick (n 115) 613

<sup>122</sup> Ibid., 619

### 2.2.3 Fiduciary law

Fiduciary law comes from the Latin word *fiducia*, meaning trust.<sup>123</sup> *Fiducia* used to be applicable in everyday relationships, whereby both involved parties were still alive (in contrast to *fideicommissum*); accordingly, at first glance, it is noted that it could have been more easily applied in its regulation to the regulation of the fiduciary duty of directors than is the case for *fideicommissum*. Moreover, trust was inherent under fiduciary law, as is necessary for the relationship between directors and the company, wherein the person trusting another person with an object believes that the object will ultimately be returned to its original owner in its original form; which trust gives rise to the formulation of the fiduciary duty.

However, this law of *fiducia*, as defined by Roman law, could only arise in instances wherein the owner of an object gave it to another person, and the owner could easily reclaim the object whenever he deemed appropriate, although the person who possessed the object had a right to expenses.<sup>124</sup> There were two sorts of *fiducia*.<sup>125</sup> The first category was *fiducia cum amico*, wherein the object (referred to as *res* under Roman law), including its dominium, was transferred to another person by way of loan; this could either be a loan for use or a loan for safe-keeping. In both instances, however, there would be an agreement that the *res* should be returned in due course. There was also the *fiducia cum creditore*, which consisted of the transfer of ownership of the *res* as security for a debt, with an agreement to retransfer the *res* when the debt was repaid. If it was not, the transferee could keep or sell the *res* because it would become

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<sup>123</sup> ‘An Introduction to Corporate Regulation and Standardization’ <[http://legal.practitioner.com/regulation/standards\\_9\\_3\\_6.htm](http://legal.practitioner.com/regulation/standards_9_3_6.htm)> accessed 7 June 2014; American Bar Association, ‘Corporate Governance and Fiduciary Duties’ <<http://apps.americanbar.org/buslaw/newsletter/0026/materials/46.pdf>> accessed 7 June 2014

<sup>124</sup> Lee (n 118) 339-340

<sup>125</sup> Thomas Glyn Watkin, *An Historical Introduction to Modern Law, Laws of the Nations Series*, (1<sup>st</sup> edn, Dartmouth Publishing Company Limited 1999) 267

his property. In addition, this type of relationship implied that there was no need for any formal contract for the creation of this special relationship, merely an agreement between two persons. Hence, *fiducia*, under Roman law, only refers to the transposition of an item without specifically requiring a contract.<sup>126</sup> Consequently, this definition of fiduciary law is distinct to the relationship between directors and companies whereby companies depend on shareholders for investment, rather than directors, and shareholders can never reclaim back what the directors do in the best interests of the company since shareholders invest in the company and can only get the profit when it is claimed by the directors.

#### **2.2.4 Mandate law**

Mandate law was created around 125 BCE.<sup>127</sup> The rule of mandate originated in the need, which arose frequently, to have one person act for another<sup>128</sup> under circumstances in which all parties involved are alive (as opposed to trust law) and where there is no right to reclaim the object entrusted to the person acting on one's behalf as there usually would be no transfer of objects (as opposed to fiduciary law). Consequently, mandate law can from the outset be used to regulate the relationship between directors and the company. This theory is further elaborated by Lee, who argues that the mandatary is looked upon as the mandator's employee.<sup>129</sup> In view of this, therefore a mandate is defined as:

‘a contract whereby one person [mandator] gives another [mandatarius] a commission to do something for him without reward, and the other accepts the

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<sup>126</sup> Ibid., 340

<sup>127</sup> Alan Watson, ‘The Evolution of Law: The Roman System of Contracts’ (University of Georgia School of Law 4-1-1984). The rules and definition of mandate law were created around this time, particularly the emphasis that it is a gratuitous contract

<sup>128</sup> Burdick (n 115) 460

<sup>129</sup> Lee (n 118) 336

commission. It is imperfectly bilateral [whereby an immediate duty on the mandatarius on one side and only a contingent duty on the mandator to indemnify the mandatarius]'.<sup>130</sup>

Hence, a mandate can be defined as a gratuitous contract that does not bind a third party.<sup>131</sup> This gratuity element reinforces the trust element, which is the core of the fiduciary duty<sup>132</sup> because a person has to fully trust another person and to firmly believe that the other person will ultimately obey the instructions given and fully act for the benefit of the mandator without being paid for the performance of the action.<sup>133</sup>

### 2.2.5 Agency law

During the same period as the creation of mandate law, agency law also began to emerge under Roman law.<sup>134</sup> Some scholars believe that the philosophy of the creation and applicability of agency law is interchangeable with mandate law, and 'mandate contributed in the development of agency'.<sup>135</sup> This theory is supported due to three striking similarities, which arise between mandate law and agency law as will be defined herein. Firstly, both mandate law and agency law are based on a relationship between two persons, both alive, and that this relationship can

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<sup>130</sup> Lee (n 118) 334

<sup>131</sup> Burdick (n 115) 427

<sup>132</sup> Ibid., 460 Burdick states that either party to the contract could be found liable for bad faith, which indirectly implies that both parties are required to act in good faith; this good faith principle gave rise to the duty of loyalty

<sup>133</sup> Ibid., 460

<sup>134</sup> The law of agency was not fully developed under Roman law as it was under the English jurisprudence. Agency law was used under Roman law when the agents had no contractual capacity and could be sued directly by third parties for any agreement entered into by them; Paul Du Plessis, *Borkowski's Textbook on Roman Law* (5<sup>th</sup> edn, Oxford University Press 2015) 290

<sup>135</sup> Lee (n 118) 336

arise out of a contractual relationship that seems to also include an employment relationship.

Thus

‘agency implies a contractual relation [that is] established between one person termed the principal and a third party by another person termed the agent, who acts as intermediary. Mandate is essentially a contract of employment and its rules are concerned only with the reciprocal rights and duties of the mandator and the mandatarius [mandatary] on the other’.<sup>136</sup>

Secondly, agency law and mandate law both imply that the mandatary and the agent are required to show clearly that they are acting on behalf of another person, as they would otherwise be personally liable for any action.<sup>137</sup> Thirdly, an agency relationship similarly portrays a fiduciary duty based on a trust relationship between two persons, as under mandate law, whereby a person (termed the principal) trusts another person (the agent) to carry out an act on his behalf, again as in the case of mandate law. If trust were to be absent, a person would not feel comfortable giving authority to another person to act in their stead.

However, other legal scholars believe that agency law developed very slowly under Roman law, as it was inconceivable that a third party who was not part of the binding contract with the principal could sue or be sued by the principal, and vice versa.<sup>138</sup> A similar approach seems to arise from the definition of agency provided above, which shows that, while mandate law demonstrates that a relationship exists between two persons, and therefore between the

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<sup>136</sup> Ibid., 336

<sup>137</sup> Clive Maximilian Schmitthoff, *Clive M. Schmitthoff's Select Essays on International Trade Law* (1<sup>st</sup> edn, Kluwer Academic Publishers 1988) 309; Ibid 330. In both agency law and mandate law, if the agent or the mandatary does not disclose the name of his principal or mandator, he will be personally liable for any action by the third party

<sup>138</sup> Burdick (n 115) 460

mandatary and the mandator only, agency law entails a triangular relationship whereby the principal enters into a relationship with a third party through the agency's persuasion. Additionally, agency law and mandate law cannot be used interchangeably, since three fundamental distinctions can be observed between these two bodies of laws. Firstly, whereas the law of mandate implies that it is a gratuitous contract,<sup>139</sup> agency law does not.<sup>140</sup> Secondly, an agent is required to carry out a juristic act, whereas a mandatary does not have to carry out such an act, but merely performs the act.<sup>141</sup> Thirdly, although both mandate law and agency law give rise to the fiduciary duty, they are differently defined (vide Chapter 4). In fact, such differing definitions led to the fact that different legal systems preferred to rely on different legal sources, such that while the civil legal system opted for mandate law, the English common legal system opted for the application of agency law to regulate the relationship between directors and the company. Hence, as a result, fundamental differences exist in the relationship between directors and companies under these two legal systems.

## **2.3 The evolution of the fiduciary duty of directors in the Italian Legal System**

### **2.3.1 Introduction**

Under the civil legal system, unlike the common legal system, the law of mandate was always applicable with regards to the regulation of the fiduciary duty of directors. Hence, trust law and agency law, as applied under the English legal system, never made their way into the Italian legal system and have always been considered anomalies, despite the fact that the use of trusts

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<sup>139</sup> Ibid., 428.

<sup>140</sup> William Alexander Hunter, *A Systematic and Historical Exposition of Roman Law in the Order of a Code* (1<sup>st</sup> edn, Colston and Coy Limited 1920) 482.

<sup>141</sup> Avinash Govindjee and Dave Holness, *Fresh Perspectives: Commercial Law 2* (1<sup>st</sup> edn, Maskew Miller Longman 2007) 17

may have an important effect in other various areas involving company law.<sup>142</sup> Nevertheless, the law of mandate is also founded on the application of the fiduciary duty, which is itself based on the principle of trust, as the other legal regimes that form part of the English legal system and the importance of various stakeholders' interests have also gained prominence over time. Consequently, fiduciary law has always been considered to form part of the Italian legal system, as clearly expressed by the Italian legal writer Renato Rordorf.<sup>143</sup> This remains true because, even though fiduciary law was not accepted under Italian statute law or case law until the 2003 statutory reforms, the direct referencing of mandate law was abrogated and a more general approach adopted.

### 2.3.2 Mandate law

Specific reference to the law of mandate in its regulation and interpretation of the fiduciary duty of directors has been present from the very first enactment of the Italian Commercial Code of 1865 until 2003. This Italian Code was influenced by the French Code de Commerce of 1807. This Commercial Code specified under article 129<sup>144</sup> that an anonymous company shall be administered by mandataries, who are temporarily elected, and can be either shareholders or non-shareholders of the company.<sup>145</sup> However, it did not enlist the mandate provisions at the time, meaning that reference to the Italian Civil Code 1865 was necessary.

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<sup>142</sup> Rosalind F. Atherton, *Estates, Taxes and Professional Ethics: Papers of Estate and Trust Law*, (1<sup>st</sup> edn, Zuidpoolsingel, Netherlands the International Academy 2004) pp 7

<sup>143</sup> Renato Rordorf, 'Le Societa per Azioni dopo la riforma: il sistema dei controlli' (2003) 126(9) *Il Foro Italiano* 183-184, 191-192

<sup>144</sup> Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp and Mark D. West, 'The Evolution of Corporate Law: A Cross Country Comparison', <<https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1287&context=jil>> accessed 5 June 2015. This code is considered to be the first of the general corporate statutes to be enacted

<sup>145</sup> Article 129, Codice di Commercio 1865. Available at <<http://www.antropologiagiuridica.it/codecomit65.pdf>> accessed 5 December 2014

The original provisions of the law of mandate under the first Italian Civil Code 1865<sup>146</sup> were also greatly influenced by the French Code Civil of 1804, and this Napoleonic Code was in turn greatly influenced by Roman law.<sup>147</sup> Nevertheless, the general approach is to refer to the Italian Code as being influenced by this French Code rather than by Roman law, as this French Code was the first real codification from the works of Justinian and was consequently easily accessible. Accordingly, the French Civil Code was considered the origin of codification.<sup>148</sup> The French Code enacted the mandate provisions beginning with Article 1984<sup>149</sup> which provide that the mandatary must act in the best interest of the mandator, and so the fiduciary duty seems to have been applied only in the best interests of the mandator, with other third parties' interests being ignored.

Nevertheless, this situation wherein commercial matters are regulated by one code, while civil matters – including the law of mandate, which could also apply to commercial matters – are regulated by another had changed slightly by the time the 1942 Italian Civil Code was enacted which grouped both commercial and civil matters under one code. Indeed, the mandate provisions are now found under different headings in the same code, which are specifically found under Book IV Title III of the Italian Civil Code 1942.<sup>150</sup> Yet, such structural changes did not alter the fundamental approach to the fiduciary duty of directors, such that the same

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<sup>146</sup> Encyclopaedia Britannica, 'Italian Civil Code' <<http://www.britannica.com/EBchecked/topic/297187/Italian-Civil-Code>> accessed 10 December 2014

<sup>147</sup> Emilija Stankovic, 'The Influence of Roman Law on Napoleon's Code Civil' <<http://uir.unisa.ac.za/bitstream/handle/10500/3544/Feesbundel%20Stankovic%20E.pdf?sequence=1>> accessed 5 December 2014

<sup>148</sup> The Free Dictionary by Farlex, 'Napoleonic Code' <<http://legal-dictionary.thefreedictionary.com/Napoleonic+Code>> accessed 10 March 2015; Leon Julliot de la Morandiere, 'The Reform of the French Civil Code' (1948) 97(1) *University of Pennsylvania Law Review* pp.1

<sup>149</sup> Code Civil 1804, <[http://www.justice.gov.bf/files/Documents%20en%20ligne/Textes%20juridiques/Codes%20et%20Lois/Le\\_code\\_civil\\_de\\_1804.pdf](http://www.justice.gov.bf/files/Documents%20en%20ligne/Textes%20juridiques/Codes%20et%20Lois/Le_code_civil_de_1804.pdf)> accessed 5 December 2014

<sup>150</sup> Italian Civil Code 1942, Part V Section VI <<http://www.ordineavvocatimelfi.it/Documenti/Codice%20Civile.pdf>> accessed 10 December 2014

interpretative approach continued to apply until 2003. Article 2392 of the Italian Civil Code 1942 with respect to public companies used to state that directors were responsible towards the company as its mandataries.<sup>151</sup> Moreover, an equivalent principle used to apply with respect to private companies whereby, although the Italian Civil Code 1942 did not make explicit reference to the mandate provisions, the directors of private companies also had a fiduciary duty as in the case of any other director of a public company.<sup>152</sup>

### 2.3.3 Fiduciary law

Some Italian legal scholars have always readily accepted that fiduciary law shall be applicable with regard to the analysis and interpretation of the fiduciary duty of directors, whereby one of these scholars, Guido Alpa, asserts that mandate is a contract based on fiduciary and trust.<sup>153</sup> Alpa's observation entails that directors must apply their fiduciary duty in their dealings, and fiduciary duty was formed by the fiduciary law. Accordingly, fiduciary law must have been applicable from the very first regulation of the fiduciary duty of directors and, therefore, from the time when directors were regulated by mandate law.

From a statutory or case law perspective, however, fiduciary law has never been readily accepted<sup>154</sup> even though in 2003, any specific reference to mandate law under statute law with

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<sup>151</sup> Giovanna Cucinella, 'La Responsabilita' degli Amministratori di Societa' di Capitali: Aspetti Civilistici e Penali' (ODCEC Palermo, 14 March 2013) <odcecpa.it/php/dl.php?id=2241&md=173> accessed 7 June 2015.

<sup>152</sup> Carl Scarpa, *Le Decisioni dei Soci nella s.r.l* (1<sup>st</sup> edn, Giuffre' Editore 2013) 135; L. Renna, 'La responsabilita' degli amministratori di societa' a responsabilita' limitata' <<https://www.personaedanno.it/impresa-societa-fallimento/la-responsabilita-degli-amministratori-di-societa-a-responsabilita-limitata-luca-renna>> accessed 28 March 2016

<sup>153</sup> Guido Alpa, *Istituzioni di Diritto Privato* (3<sup>rd</sup> edn, UTET 2001) 429

<sup>154</sup> Irene Tagliamonte, *Crisi Finanziarie e Cooperazione Internazionale: Globalizzazione dei mercati mobiliari e circolazione di modelli giuridici* (1<sup>st</sup> edn, Polimata 2010). Also, the law does not make any reference to fiduciary law

respect to the fiduciary duty of directors was abrogated, and a general approach was sought<sup>155</sup> in the case of public companies.<sup>156</sup> Article 2392 of the Civil Code 1942 stipulates that a director shall abide by any diligence and duty that arises out of his office, and this provision suggests that everybody's interests are important, not only the interests of the company. This constitutes an application of the fiduciary law interpretation as applied under the English legal system (vide Section 2.4). Amatucci also prefers not to make any specific reference to mandate law or fiduciary law.<sup>157</sup> Accordingly, this general approach as presented by Italian legal scholars and by the statutory change also means that if reference to foreign legal systems is to be made by the Italian Courts when interpreting the fiduciary duty of directors, such an approach cannot be contested since the Courts would not be going against the mandate provisions.

At the same time, a more rigorous approach in the interpretation of this fiduciary law seems to continue to apply in the case of private companies,<sup>158</sup> as Article 2476 of the Italian Civil Code 1942 stipulates that the directors are responsible to the company for any damages that arise out of their breach of duties imposed both by law and by the memorandum and articles of association of the company,<sup>159</sup> implying that only the interests of the company as a separate legal personality from its shareholders shall be taken into consideration by the directors. In addition to this, interpretations of the mandate provisions continue to be applied with respect to the regulation of the fiduciary duty of directors, because no other laws have been enacted in

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<sup>155</sup> Civil Code <[http://www.notarlex.it/testofronte\\_riforma.pdf](http://www.notarlex.it/testofronte_riforma.pdf)> accessed 5 June 2015

<sup>156</sup> Private limited liability companies have never made specific reference to the application of mandate law to regulate the fiduciary duty of directors

<sup>157</sup> Carlo Amatucci, *Directors' Duties in Italy*, article in Research Handbook on Directors Duties by Adolfo Paolini (1<sup>st</sup> edn, Edward Elgar Publishing 2014)

<sup>158</sup> The *societa' a responsabilita' limitata* (S.R.L.) was introduced by the Civil Code of 1942, as shown in the Italy Company Law and Regulations Handbook - Strategic Information and Basic by Ibp Usa (1<sup>st</sup> edn, International Business Publication 2015), and it is more limited in its studies than public companies under Italian law

<sup>159</sup> Ibid.

this area; therefore, the same strict interpretations of the fiduciary duty as arising under mandate law continue to apply.

## **2.4 The evolution of the fiduciary duty of directors in the English legal system**

### **2.4.1 Introduction**

Through both case law and the works of legal scholars, the English legal system demonstrates that the interpretation of the fiduciary duty of directors has long been regulated by overlapping regimes, until a point at which fiduciary law was solely resorted to. Although this fiduciary duty of directors was initially regulated by trust law,<sup>160</sup> agency law later began to pave the way. Nevertheless, the fiduciary duty of directors was always regulated by fiduciary law from the time at which trust law and agency law were prominent. However, fiduciary law began to be exclusively resorted to by the nineteenth century for various reasons (as will be outlined below),<sup>161</sup> and reference to any other law was abrogated with. This analysis shall demonstrate that this change in legal regimes was necessary because every particular body of law referred to herewith has evolved to apply in a particular business context.

Although case law and legal scholars provide a useful insight into the analysis of the historical development of the directors' fiduciary duty under the English legal system, a statutory provision has never been enacted that explicitly describes which specific law from the three bodies of law referred to above should govern the fiduciary duty of directors. Therefore, statute

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<sup>160</sup> Fleischer Holger, 'Legal Transplants in European Company law – The Case of Fiduciary Duties' <<http://heinonline.org.ezproxye.bham.ac.uk/HOL/Page?public=false&handle=hein.journals/ecomflr2&page=378&collection=journals>> accessed 15 June 2018

<sup>161</sup> Ibid.

law has never unequivocally asserted whether the fiduciary duty of directors shall be governed by the special vehicle of trust law, agency law or fiduciary law, or whether these different legal regimes can be used interchangeably.<sup>162</sup> If statute law had explicitly provided a law governing the fiduciary duty of directors, any ambiguous interpretations as to what law should apply would have been automatically eliminated. This situation has remained unchanged until today, and it is even not remedied by looking at the definition of a director; statute law has never indicated whether directors should be considered as mandataries, fiduciaries, agents or trustees. Indeed, the Companies Clauses Consolidation Act 1845, considered to be the first Act to provide a definition of directors, simply states under number III that directors are defined as ‘all persons having the direction of the undertaking, whether under the name of directors, managers, committee of management, or under any other name’.<sup>163</sup> This approach has never been amended until to date, as can be clearly observed under Section 250 of the English Companies Act 2006.<sup>164</sup>

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<sup>162</sup> Alan Dignam and John Lowry, *Company Law* (6<sup>th</sup> edn, Oxford University Press 2010) 270. The authors state that ‘neither [Section 154] nor indeed the rest of the Act goes on to attribute specific functions to company directors or to lay down the structure and form of corporate management generally’

<sup>163</sup> Companies Clauses Consolidation Act 1845, s III <[http://www.legislation.gov.uk/ukpga/1845/16/pdfs/ukpga\\_18450016\\_en.pdf](http://www.legislation.gov.uk/ukpga/1845/16/pdfs/ukpga_18450016_en.pdf)> accessed 4 December 2014

<sup>164</sup> Companies Act 2006 <[http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga\\_20060046\\_en.pdf](http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf)> accessed 4 December 2014. The Companies Act of 1948 also states in Section 415 that ‘the expression ‘director’ in relation to a company includes any person in accordance with whose directions or instructions the directors of the company are accustomed to act’

## 2.4.2 Trust Law

Trust law<sup>165</sup> was the first law to be applied under the English legal system with respect to the regulation of the fiduciary duty of directors. It originated from equity law,<sup>166</sup> and equity law can in turn trace its history back to Roman law.<sup>167</sup> Trust law was, however, originally applicable only to private law issues under the English legal system, particularly to property law, and was never intended to apply to directors and their relationship with the company that they manage. In fact, trust law emerged during the twelfth and thirteenth centuries, when landowners would typically leave their property in the hands of an acquaintance in their absence with the presumption of getting the property back upon their return, or be vested in the hands of third parties upon their death.<sup>168</sup> Under such circumstances, a trust relationship between the landowner and the person entrusted with this property used to arise either under a contract or orally. In this regard, therefore, the origin of the applicability of trust law indicates that a person never obliged another person to act on his behalf.<sup>169</sup> Trust law was consequently considered very similar to the Roman law of *fideicommissum* in this respect.<sup>170</sup>

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<sup>165</sup> Trust law, as defined under the English legal system, developed differently from trust law as was understood under Roman Law. See Fleischer Holger, 'Legal Transplants in European Company Law – The Case of Fiduciary Duties' <<http://heinonline.org.ezproxye.bham.ac.uk/HOL/Page?public=false&handle=hein.journals/ecomflr2&page=378&collection=journals>> accessed 14 July 2015

<sup>166</sup> Alastair Hudson, *Equity and Trusts* (8<sup>th</sup> edn, Routledge 2015) 40; Ron Harris, *Industrialising English Law: Entrepreneurship and Business Organisations* (1<sup>st</sup> edn, Cambridge University Press 2000) 152

<sup>167</sup> Franz Wieacker, 'The Importance of Roman Law for Western Civilisation and Western Legal Thought' (Boston College International and Comparative Law Review Volume 4 Issue 2 Article 2) <<http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1585&context=iclr>> accessed 20 January 2015.

<sup>168</sup> Trust Law <[https://www.princeton.edu/~achaney/tmve/wiki100k/docs/Trust\\_law.html](https://www.princeton.edu/~achaney/tmve/wiki100k/docs/Trust_law.html)> accessed 10 February 2015

<sup>169</sup> Len Sealy and Sarah Worthington, *Cases and Materials in Company Law* (8<sup>th</sup> edn, Oxford University Press 2008) 273

<sup>170</sup> Loring and Rounds, *A Trustee's Handbook: The Origin of Trusts* (2012) 1179-1186 <<http://documents.jdsupra.com/2c6a1f87-a2c2-48ec-93ef-80b6a9924a27.pdf>> accessed 5 June 2015

Nonetheless, over time, trust law also began to be applied to the relationship between directors and companies, whereby it was during the late eighteenth and nineteenth centuries,<sup>171</sup> when the English Courts firstly applied trust law in the field of corporate law<sup>172</sup> as interpreted in the judgment *Keech v Sandford*.<sup>173</sup> Although this case did not challenge the fiduciary duty as applied to directors, it is still referred to by writers and scholars in the context of company law and has had significant influence on the Courts' subsequent reasoning when faced with the analysis of the fiduciary duty of directors,<sup>174</sup> and is continuously revisited by the Courts and legal scholars when they are faced with the need to provide a comprehensive analysis of the fiduciary duty of directors. In reality, this case concerns the law of trusts. A child, Keech, had inherited the lease on Romford Market near London, and Sanford was appointed to look after this property until the child attained the age of majority. However, before the child reached majority, the lease expired. The property owner informed Sanford that he did not want the child to have the lease renewed, but was content to give Sanford the opportunity of personally taking over the lease, which Sanford did. Keech later sued Sanford for the profit that he would have been made had the lease been renewed in his name. Lord King LC ordered Sanford to pay Keech the profits that Keech had lost due to Sanford's behaviour.

Trust law was the first law to be applied with respect to the regulation of the fiduciary duty of directors for three reasons. First, from a terminological perspective, trust law was applied when limited vocabulary was available to judges. Indeed, Sealy contends that:

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<sup>171</sup> Harris (n 166) 152

<sup>172</sup> Sealy and Worthington (n 169)

<sup>173</sup> [1726] 25 ER 223. This judgment was, however, applied in a trustee-beneficiary case and not in a director-company scenario. See also Samavati Heshmatollah, 'The Primary Fiduciary Duty of Directors and Controlling Shareholders of the Company' (Ph.D. University of Birmingham 1994) 38

<sup>174</sup> Brenda Hannigan, *Company Law* (5<sup>th</sup> edn, Oxford University Press 2018) 231

‘courts used to refer to directors as trustees because of the limited vocabulary that was present at that time and courts used to reason that since a director accepted a trust relationship therefore they shall be considered as trustees’.<sup>175</sup>

Second, it was considered appropriate to apply trust law to the regulation of the fiduciary duty of directors from the practical formation of companies and their validity at that time.<sup>176</sup> Prior to the enactment of the Joint Stock Companies Act 1844,<sup>177</sup> companies were mainly unincorporated, such that only a Royal Charter or an Act of Parliament could trigger incorporation. This approach, consequently, led to the incorporation of companies being considered an expensive luxury.<sup>178</sup> Hence, unincorporated companies were the norm, and their constitutional document was usually a simple deed of settlement vesting the assets of the company in trustees.<sup>179</sup> This approach to the formation of companies led to a situation in which the English legal system could not apply the law of mandate<sup>180</sup> (as under the civil law system) or the law of agency to the regulation of the fiduciary duty of directors because each applied to companies that were not formed by a deed of settlement, as under trust law, but of a contract. A contract and a deed of settlement are distinctive because whereas a contract requires consideration, a deed of settlement does not.<sup>181</sup>

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<sup>175</sup> Sealy and Worthington (n 168); Writeopinions.com, ‘Opinions on Joint Stock Companies Act 1844’ <<http://www.writeopinions.com/joint-stock-companies-act-1844>> accessed 5 January 2014

<sup>176</sup> David Kershaw, ‘The Path of Fiduciary Law’, LSE Law, Society and Economy Working Papers 6/2011 <[http://eprints.lse.ac.uk/38173/1/WPS2011-06\\_Kershaw.pdf](http://eprints.lse.ac.uk/38173/1/WPS2011-06_Kershaw.pdf)> accessed 4 August 2015

<sup>177</sup> Len Sealy, ‘The Director as Trustee’ (1967) 25(1) *Cambridge Law Journal* 83-103 DOI: 10.1017/S0008197300011223

<sup>178</sup> Competition Commission, ‘Audit Market Investigation: Developments of the statutory financial audit’ <[https://assets.digital.cabinet-office.gov.uk/media/5329db4140f0b60a76000016/development\\_of\\_the\\_statutory\\_financial\\_audit.pdf](https://assets.digital.cabinet-office.gov.uk/media/5329db4140f0b60a76000016/development_of_the_statutory_financial_audit.pdf)> accessed 28 December 2014

<sup>179</sup> Heshmatollah (n 173) cited Gower on page 25; L.S. Sealy (n 176) 103

<sup>180</sup> The law of mandate is applicable in the civil law system. It is fully enforceable to this day in Italian law with respect to directors. In Malta, the law of mandate has been superseded by fiduciary law.

<sup>181</sup> Mark Ellis, ‘Deed or Contract?’ (Fresh Business Thinking.com) <[http://www.freshbusinessthinking.com/articles\\_print.php?CID=0&AID=1648](http://www.freshbusinessthinking.com/articles_print.php?CID=0&AID=1648)> accessed 10 February 2015; Tim Manefield, ‘Agreement vs. Deed’ (LegalTalk Alert, PriceWaterHouseCoopers, Issue 12 April 2010) <<http://www.pwc.com.au/legal/assets/legaltalk/LegalTalk-12Apr10.pdf>> accessed 10 February 2015; Reece

Third, English trust law found application in corporate law because it applied fiduciary duty,<sup>182</sup> particularly the good faith principle, to the relationship between directors and the company.<sup>183</sup> Fiduciary duty is important in company law because it is a duty that is not based on the simplicity of morality, which is based on one's unique way of living,<sup>184</sup> but rather on an approach that must be ultimately achieved by any person. Fiduciary duty is based on what is termed *fiduciary loyalty*, wherein such loyalty does not necessarily need to be based on loyalty as defined in moral terms.<sup>185</sup> Consequently, a fiduciary duty can be defined as 'a contractual gap-filler, premised on a hypothetical bargain between the parties'.<sup>186</sup>

However, any reference to trust law lost ground over time and could not continue to be applicable in the evolving business context for five main reasons; two of which are however not readily acceptable as they can be disputable and are discussed as the first two reasons. First, under trust law, a settlor can act either as the trustee or the beneficiary or both as trustee and beneficiary at the same time.<sup>187</sup> However, in the case of a company as a legal entity in its own right, a shareholder or director can never also act as the company, with the result that the ultimate beneficiary (i.e. the company) is always a different person from the one who invests as a shareholder, or who manages those assets as a director. In fact, shareholders as legal

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Allen, 'Deed I do if signed and delivered: *400 George Street (QLD) Pty Limited v BG International Limited*' 25(1) *Bond Law Review* 6

<sup>182</sup> John H Langbein, 'Questioning the Trust-Law Duty of Loyalty: Sole Interest or Best Interest?' (Yale Law School 2005). *Faculty Scholarship Series*, Paper 495

<sup>183</sup> D. Wright and Brian Creighton, *Rights and Duties of Directors* (2<sup>nd</sup> ed, Butterworth and Co. 1998) 9

<sup>184</sup> D. Gordon Smith and Andrew S. Gold, *Research Handbook on Fiduciary Law* (1<sup>st</sup> edn, Edward Elgar Publishing Limited 2018) 187

<sup>185</sup> *Ibid.*, 38

<sup>186</sup> *Ibid.*, 40. This quote was taken from the influential American judgment in *Jordan v Duff & Phelps* (1987). Reference to the American legal system can be considered alongside those to the English legal system, as both are based on the same common law principles and the same principles of trust law and agency law

<sup>187</sup> Paul Todd and Sarah Lowrie, *Textbook on Trusts* (5<sup>th</sup> edn, Black Stone Press 2000) 47. The only exception in this regard is that a settlor cannot act as the sole trustee and sole beneficiary as well but the trustee can act as the trustee and the beneficiary at the same time when there are other persons involved in the trust as beneficiary or trustees.

beneficiaries are only entitled to the dividends in the company when they are declared by the directors and when a profit is declared on behalf of the company. In reality, however, the shareholders control these directors' actions, even if such notion might not be clearly dictated by the law or by any memorandum and articles of the company, since shareholders enjoy the power to elect or change directors at their discretion.<sup>188</sup> Consequently, it seems that although in principle the company is the ultimate beneficiary, in reality the ultimate beneficiary is the shareholder as the shareholder dictates the director's actions and pushes for a dividend to be declared, especially in a 'one-man' company.

Second, one might also determine that, although the fiduciary duty used to be applied in the case of directors, as a general rule, trust law is based on conscience,<sup>189</sup> as opposed to agency law,<sup>190</sup> mandate law<sup>191</sup> and fiduciary law.<sup>192</sup> Conscience can be interpreted widely based on different morals, theologies, teachings and backgrounds, which will therefore lead to different results.<sup>193</sup> Consequently, if the same situation is presented before two different directors, even if they work in the same environment and they must apply the fiduciary duty, they may still easily reach different conclusions since the outcome is based on what they perceive as right or

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<sup>188</sup> Mark Freeman, Robin Pearson and James Taylor, 'Law, politics and the governance of English and Scottish joint-stock companies, 1600-1850', *Business History*, 2013 Vol. 55, No. 4, 633-649, <<http://eprints.gla.ac.uk/69922/1/69922.pdf>> accessed 5 June 2018

<sup>189</sup> See Hudson (n 166) 522. Here, he cites his own book, *The Law of Trusts*, and asserts that 'The essence of a trust is the imposition of an equitable obligation on a person who is the legal owner of the property (a trustee) which requires that person to act in good conscience when dealing with that property'

<sup>190</sup> Elspeth Christie Reid and D.L. Carey, *A Mixed Legal System in Transition: T. Smith and the Progress of Scots Law* (1<sup>st</sup> edn, Edinburgh University Press, 2005). The authors assert that agency law is not based on conscience, but is rather based on the rigid law that one has to abide by

<sup>191</sup> Mandate law has never found a place in English jurisprudence. Nonetheless, it law is not based on conscience, but on the applicability of the law, irrespective of one's conscience

<sup>192</sup> Fiduciary law is not based on conscience because a fiduciary has to always act in the interests of, and for the benefit of, a third party, even if that interest is against his own conscience <<http://impactethics.ca/2015/03/05/fiduciary-duties-limit-physicians-freedom-of-conscience/>> accessed 10 May 2015

<sup>193</sup> Hudson (n 166) 11

wrong, with the consequence that third parties can be highly prejudiced. However, in reality, the specific application of the fiduciary duty does not draw any distinction among trust law, agency law or fiduciary law.

Whereas the above two reasons can be controversial among scholars, the other three reasons, herein explained, are perhaps less contentious. Accordingly, the third reason why trust law lost ground over time in the evolving business context according to some legal scholars, trustees and directors were considered as two distinct bodies with different duties.<sup>194</sup> Each is required to abide by their fiduciary duty, but certain duties may not apply to directors under trust law and vice versa, which duties, however, go beyond the fiduciary duty, or more precisely, the duty of loyalty. The concept of directors as trustees was challenged in *Re: City Equitable Fire Insurance Co*,<sup>195</sup> in which Romer J held that trustees and directors are two distinct bodies and cannot be considered interchangeable:

‘..it is sometimes said that directors are trustees. If this means no more than those directors in the performance of their duties stand in a fiduciary relationship with the company, the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading. I can see but little resemblance between the duties of a director and the duties of a trustee of a will or a marriage settlement’.

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<sup>194</sup> Sealy (n 177) asserts that ‘it is argued that considering a director as trustee is wholly wrong for the following reasons:

All cases deal with corporations – therefore there was not only a normal deed of settlement and the oldest case that deals with the fact that directors were considered trustees by court of a corporation is *Charitable Corporation v Sutton*

Trustees and directors were considered as two distinct bodies in the deed of settlement of the company and there were distinct rules for each

In some cases directors were liable as trustees whereas the trustees themselves were exonerated’

<sup>195</sup> [1925] Ch 407

Romer J's thinking was later echoed by Davies,<sup>196</sup> who also acknowledges that the trustee and the director are two distinct bodies that cannot be considered interchangeable because they hold different duties, which nevertheless go beyond the ordinary fiduciary duty.

Fourth, trust law does not impose a duty to act with respect to those assets that are placed in a person's hand; it is only a situation of convenience whereby a person places his assets in the hands of another person until the assets are handed back. Consequently, under the strict application of trust law, the assets transferred remain the property of the transferor and are not legally transferred to another corporation or person. However, in the case of a company, shareholders invest their money in the company for the company's benefit, and as a result, shareholders lose their rights over those assets since those assets are transformed and invested, even though those same shareholders will eventually reap the benefits.

Fifth, trust law is founded on the deed of trust, which does not enjoy a separate legal personality. The principle of separate legal personality is a fundamental concept in the evolving discipline of corporate law wherein corporations enjoy a legal personality separate and distinct from that of their shareholders and directors.<sup>197</sup> Consequently, neither the directors nor the

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<sup>196</sup> Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (7<sup>th</sup> edn., 2003) 496. He cited the judgment in *Re: City Equitable Fire Insurance Co* [1925] Ch 407 and also states that 'to describe directors as trustees seems today to be neither strictly correct nor invariably helpful'

<sup>197</sup> Davies (n 196) 495-496. He asserted that directors were 'regarded as trustees in the eyes of the court of equity in so far as they dealt with the trust property. With directors of incorporated companies the description 'trustees' was less apposite, because the assets were now held by the company, a separate legal person, rather than being vested in trustees'. The separate legal personality theory is important because it limits the liability that can be attributed to directors; however, agency law, like trust law, does not abide by the separate legal personality principle, since shareholders still hold full control over directors. See also Nyombi Chrispas and David Justin Bakibinga, 'Corporate Personality: The Unjust Foundation of English Company Law' <<http://web.b.ebscohost.com.ezproxye.bham.ac.uk/ehost/pdfviewer/pdfviewer?vid=1&sid=a1838701-e0d0-4f9f-8366-877341d7948f%40sessionmgr104>> accessed 15 July 2016

shareholders can be held personally liable for acts performed by the company, unless there has been fraudulent or wrongful trading on the part of the directors; in these instances, the directors will be held personally liable.<sup>198</sup> This separate legal personality principle means that the company is personally liable to third parties for any acts it commits and can also be sued and sue in its own name. The concept of separate legal personality gained prominence in the United Kingdom in the nineteenth century with the *Salomon Case*.<sup>199</sup> It was held that, although the company was managed by one person (Salomon), as a director he was not liable for acts done by the company. This principle of separate legal personality enjoyed by the company is now fundamental in company law. This case concerned Aron Salomon, who used to make leather boots and shoes in a large Whitechapel High Street establishment. Over time, his sons expressed the desire to join their father's business; accordingly, their father decided to turn the business into a limited liability company. His wife and his five elder children became subscribers and the two elder sons were also appointed as directors, but were in fact acting as nominees for their father. This structural formation therefore meant that this company was still a one-man business. After its formation, the company purchased Salomon's business of the formation of boots for £39,000, an excessive price for its value, which took place on 1<sup>st</sup> June 1892. As part of the transfer, Salomon took 20,001 of the company's 20,007 shares as payment, each of which was worth £1. The company also gave Salomon £10,000 in debentures. However, soon after the transfer, the market for boots collapsed, principally due to strikes that were being held at the time. Under these circumstances, the government of the day, which was Salomon's main customer, decided to split its contracts between more firms to avoid the risk of its few suppliers being affected by these strikes. These circumstances inevitably led to Salomon's business failing and the company was put into liquidation. After the interest

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<sup>198</sup> Articles 315 and 316 of the Maltese Companies Act regulates fraudulent and wrongful trading respectively. A study on wrongful and fraudulent trading would have merited a study on its own

<sup>199</sup> *Salomon v A Salomon & Co Ltd* [1896] UKHL 1

payments on the debentures were repaid, the company was left with only £1,055 in assets, which were claimed by Salomon under his retained debentures. As a result, unsecured creditors were left with nothing. The liquidator was of the opinion that Salomon should pay these creditors, but Salomon refused. The High Court decided against Salomon, yet the Court of Appeal overturned that decision and ordered that Salomon had to pay the unsecured creditors, but only on the basis that the company was formed for an illegitimate purpose. Hence, the Court of Appeal's decision made it clear that an incorporated company must be considered a legal entity on its own. Lindley LJ said that:

‘The incorporation of the company cannot be disputed. The company must be regarded as a corporation. I do not go so far as to say that the creditors of the company could sue him. In my opinion, they can only reach him through the company’.<sup>200</sup>

The House of Lords overturned part of the Court of Appeal's decision and held that Salomon could not be held personally liable for the company's creditors, as it had not been sufficiently proven that he had defrauded them, with the result that Salomon was not held liable for anything. With respect to the separate legal personality enjoyed by the company, however, the House of Lords adopted the Court of Appeal's principle that the company is a legal entity in its own right. It was stated that:

‘the company is at law a different person altogether from the subscribers to the memorandum [...] the company is not in law the agent of the subscribers or trustee for them’.<sup>201</sup>

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<sup>200</sup> Trans-lex.org, Salomon v. Salomon & Co Ltd [1897] AC 22, <[https://www.trans-lex.org/310810/\\_/salomon-v-salomon-co-ltd-%5B1897%5D-ac-22/](https://www.trans-lex.org/310810/_/salomon-v-salomon-co-ltd-%5B1897%5D-ac-22/)> accessed 10 July 2016

<sup>201</sup> Ibid.

The *Salomon* case represents a clear example of private limited liability companies, which are usually family business companies made up of shareholders who typically also sit on the board of directors; yet, these companies still enjoy separate legal personality from their shareholders and directors, as has been readily accepted by the Courts.<sup>202</sup> This principle can work in favour of directors and shareholders, but at the same time works against creditors and other third parties who have an interest in the company. The separate legal personality entails that directors are required to apply their fiduciary duty in light of the company's interests and not in the interests of the shareholders or other stakeholders. Nevertheless, at the same time, one might think that the separate legal personality principle is purely a sham invented and applied in the corporate field of law simply to shield directors and shareholders from any actions brought by third parties as, in reality, the separate legal personality principle does not apply in its true sense because shareholders have enjoyed the right to change directors from the 18<sup>th</sup> century onwards,<sup>203</sup> and shareholders and directors can also be the same people. Therefore, shareholders seem to have always enjoyed indirect control over the directors by enjoying the full power to elect and choose the directors of the company, and so have had indirect controlled the actions of the company since directors might decide to act in the name of the shareholders to ensure that they are re-elected, even more so when the director and the shareholder are the same person. However, following *Salomon*, the Courts have seemed to strictly apply the separate legal personality principle.

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<sup>202</sup> Mathias Reidman and Reinhard Zimmermann, *The Oxford Handbook of Comparative Law* (1<sup>st</sup> edn, University Press 2006) 1164. There might, however, be instances whereby private companies are made up of many shareholders, who are different from the directors, but who do not change with the same frequency as public companies. By contrast, public companies began to be created during the nineteenth century, at which time the separate legal personality of the company continued to be even more significant than was the case for private companies. Public companies have shares that are publicly traded and listed on a trading venue, with the result that the many different shareholders are constantly changing and totally separated from the directors of these companies

<sup>203</sup> Freeman, Pearson and Taylor (n 188)

### 2.4.3 Agency law

Trust law was limited in its application in the evolving corporate law and a new body of law had to be formulated. Lord Cranworth LC defined an agency relationship in *Aberdeen Rlwy. Co. v Blaikie Bros.*<sup>204</sup> as one in which ‘such agents have duties to discharge of a fiduciary nature towards their principal’.<sup>205</sup> Bowstead and Reynolds also state that ‘an agency could be defined as a fiduciary relationship where one is acting on behalf of another subject to the consent and instruction by the principal’.<sup>206</sup> This agency relationship, which can be created either orally or by a written contract, can thus be defined as a relationship in which:

‘an agent can act only within what is known as the agent’s ‘authority’: the principal of an agent is not bound by any legal relationship which the agent purports to put the principal into if it was outside the agent’s authority’.<sup>207</sup>

However, certain other legal scholars such as Fridman<sup>208</sup> tend to go one step further and assert that an agency relationship requires the agent to act on behalf of the principal to bind a third party.<sup>209</sup>

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<sup>204</sup> (1854) 1 Macq. 461, 471.

<sup>205</sup> This principle is again cited by Alistair Hudson, *The Law of Finance* (1<sup>st</sup> edn, Sweet & Maxwell 2009) 99, who states that ‘agents bear fiduciary obligations above and beyond their contractual duties’

<sup>206</sup> Law Teacher, ‘Directors Duties from View of Agency Law’ <<http://www.lawteacher.net/business-law/essays/directors-duties-from-view-of-agency-law-business-law-essay.php>> accessed 5 December 2014.

<sup>207</sup> Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French & Ryan on Company Law* (29<sup>th</sup> edn, Oxford University Press 2012) 618

<sup>208</sup> M.A. Clarke, R.J.A Hooley, R.J.C Munday, L.S Sealy, A.M Tettenborn and P.G Turner, *Commercial Law: Text, Cases and Materials* (5<sup>th</sup> edn, Oxford University Press 2017) 109. Fridman defines an agency relationship as one whereby an agent has the power to alter the relationship of the principal with a third party

<sup>209</sup> Lee (n 118)

While legal scholars tend to agree on the definition of agency, they also agree that it is difficult to provide a precise historical start date<sup>210</sup> for the creation of agency law in the common law system, but agree that it found its footing with the establishment of new corporate principles that ran against trust law, primarily the separate legal personality principle and the way new companies were being formed in which the deed of settlement was considered to be obsolete.<sup>211</sup> Consequently, the Courts held that trust law and agency law were different, and came to the conclusion that these two bodies of laws apply to different times during the directors' relationships with the company and with third parties, albeit still with the principle of trust through the fiduciary duty of directors ingrained in every relationship. This dual, non-conflicting and non-related relationship enjoyed by directors is perhaps best expressed by Lord Selborne in the judgment in *Great Eastern Railway Co v Turner*,<sup>212</sup> in which he held that:

The directors are the mere trustees or agents of the company – trustees of the company's money and property; agents in the transactions which they enter into on behalf of the company'.

Another distinction between trust law and agency law is in the notion that while trust law is founded on the flexibility of equity law, agency law is ingrained in common law.<sup>213</sup>

Yet, at the same time, it is noted that the interchangeable use of trust law and agency law seems to also be acceptable in the field of corporate law for three main reasons. First, although it is established as a rule that agency law introduced the principle of the company's separate legal

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<sup>210</sup> Paula J Dalley, 'A Theory of Agency Law', 72 *University of Pittsburgh Law Review* 495. Harris stated that agency law was created in the eighteenth century in his book *Industrialising English Law: Entrepreneurship and Business Organisations* (page 158)

<sup>211</sup> Harris (n 166) 165

<sup>212</sup> (1872) 8 Ch. 149, 152

<sup>213</sup> Adams G.B., 'The Origin of English Equity' (1916) 16(2) *Columbia Law Review* 87-98. The distinction between equity and common law appeared only in the fourteenth century. Since the notion of companies originated in the nineteenth century, the distinction between equity and common law shall be applied

personality with the consequence that directors are trusted by and responsible towards the company, the reality is that shareholders remain at the core of the company's control over directors because they enjoy the right to elect and choose the directors. Accordingly, the shareholders' interests were considered to be the principal interests which needed to be fully protected by directors. This specific scenario arises when the director and the shareholder are one and the same person, in which the separate legal personality enjoyed by the company is blurred and does not apply in everyday transactions. This notion of separate legal personality was, therefore, not genuinely abided by under this specific legal regime.<sup>214</sup> Second, some legal scholars such as Sealy believe that reference to trust law had long been ingrained in the field of corporate law when analysing the fiduciary duty of directors with the result that reference to trust law could not be ignored.<sup>215</sup> Third, because the trust principle (through the fiduciary duty enjoyed by directors)<sup>216</sup> was as prominent under agency law as under trust law, there are similar interpretations of this specific duty under each legal system. The application of the fiduciary duty under agency law was first tackled in *Armstrong v Jackson*,<sup>217</sup> in which Lord McCcardie pointed out that:

‘The position of principal and agent gives rise to particular and onerous duties on the part of the agent, and the high standard of conduct required from him springs from the fiduciary relationship between his employer and himself’.<sup>218</sup>

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<sup>214</sup> Lowry (n 177) 271. Vide also David Collison, Stuart Cross, John Ferguson, David Power d & Lorna Stevenson, ‘Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence’ <[estrathprints.strath.ac.uk/32336/1/Shareholder\\_Primary\\_in\\_UK\\_Corporate\\_Law.doc](http://estrathprints.strath.ac.uk/32336/1/Shareholder_Primary_in_UK_Corporate_Law.doc)> accessed 4 July 2017 which also talk extensively about agency theory, which emphasises the importance of protecting the shareholders' interests over the interests of the company

<sup>215</sup> Sealy (n 116)

<sup>216</sup> Deborah A. DeMott, ‘Disloyal Agents’ 58(5) *Alabama Law Review* 1049

<sup>217</sup> [1917] 2 KB 822

<sup>218</sup> The Letting Centre, ‘Agency’ <[http://www.letlink.co.uk/index.php?option=com\\_content&view=article&id=303&Itemid=100046](http://www.letlink.co.uk/index.php?option=com_content&view=article&id=303&Itemid=100046)> accessed 5 December 2014

A more recent judgment that also applies the fiduciary duty of directors under agency law is *Daraydan Holdings Ltd v Solland International Ltd*.<sup>219</sup> Hudson also makes reference to the importance of the fiduciary duty as imposed on the directors under agency law.<sup>220</sup> However, over time, reference to agency law decreased, as in the case of trust law. This was because agency law presented an idea of the directors who remained very strongly linked to the shareholders, with the result that the fiduciary duty of these directors was owed to shareholders rather than to the company. Therefore, the separate legal personality of the company could only be effectively adopted if any reference to agency law and trust law was removed.

#### **2.4.4 Fiduciary law**

Fiduciary law had to be created due to the problems created under trust law and agency law. Under the English legal system, fiduciary law was created in the 14<sup>th</sup> century,<sup>221</sup> which evolved under equity law as trust law. Fiduciary law was applied even during the enforcement of trust law and agency law, for two noteworthy reasons. First, it gave rise to the fundamental fiduciary duty of directors that is also undoubtedly applied under trust law and agency law,<sup>222</sup> as already demonstrated above. The principle of trust and confidence that arises between two persons, which may include the relationship between directors and the company that they manage,<sup>223</sup> as under trust law and agency law, is once again prominent. Second, fiduciary law found

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<sup>219</sup> [2004] EWHC 622; [2004] 3 WLR 1106; [2005] Ch 1. This judgment can be accessed through <<http://www.nadr.co.uk/articles/published/AdjudLReports/DARADAYSvSOLLAND2004.pdf>> accessed 5 December 2014

<sup>220</sup> Hudson (n 166) 72

<sup>221</sup> David Sciulli, *Corporate Power in Civil Society: An Application of Societal Constitutionalism* (1<sup>st</sup> edn, New York University Press 2001) 21

<sup>222</sup> Kershaw (n 176) 7. In fact, he states that 'fiduciary law [is] contained within English trust law and agency law'

<sup>223</sup> Reidmann and Zimmermann (n 200) 154

applicability in instances where the law of trusts<sup>224</sup> and the law of agency<sup>225</sup> could not be applied. In this regard, fiduciary law is defined as the law that:

‘can accommodate new situations and changes in social morals and norms, yet maintain its core values and norms, without which no society can survive, let alone flourish’.<sup>226</sup>

Fiduciary law was therefore resorted to when trust law<sup>227</sup> and agency law<sup>228</sup> could not fill all the gaps that were being created over time.<sup>229</sup> One such instance involves the evolution of the law with respect to the economic needs that were being created over time,<sup>230</sup> such as circumstances in which directors were required to take risky actions for the benefit of the company.<sup>231</sup>

However, fiduciary law began to be entirely and solely resorted to under the English legal system without any reference to trust law or agency law from the 20<sup>th</sup> century onwards. It became significant when the separation between management and ownership could no longer be subdued. In short, the principle of the separate legal personality enjoyed by the company

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<sup>224</sup> Smith and Gold (n 184)

<sup>225</sup> Kershaw (n 176)

<sup>226</sup> Tamar Frankel, ‘Fiduciary Law in the Twenty-First Century’ 91 *Boston University Law Review* 1289.

<sup>227</sup> Trust law was mainly created for unincorporated companies. Although it was applied to companies whenever they were formed, in reality, it was not created to deal with these companies, but was only applied to them out of convenience

<sup>228</sup> The definition of agency law involves the shareholder’s supreme control over directors, control that could not be exercised anymore with the introduction of the separate legal personality theory.

<sup>229</sup> Deborah A. De Mott, ‘Beyond Metaphor: An Analysis of Fiduciary Obligation’ (1988) *Duke Law Journal* 879. Vide also Kershaw (n 176)

<sup>230</sup> Kershaw (n 176)

<sup>231</sup> Holger Fleischer, ‘Legal Transplants in European Company Law – The Case of Fiduciary Duties’, ECFR 2005, 378-397

<<http://heinonline.org.ezproxye.bham.ac.uk/HOL/Page?public=false&handle=hein.journals/ecomflr2&page=378&collection=journals>> accessed 10 August 2018

had in principle created the notion that directors are answerable to the company only, and were consequently enjoying more trust and less control from the shareholders; this stood in opposition to trust law and agency law, under which directors were automatically considered to be directly controlled by the shareholders, especially in one-man companies. This separate legal personality principle, as defined under fiduciary law, meant that it must also apply with the same rigidity in a one-man company in which, although the shareholder and the director were the same person, the director still has to act in the best interests of the company. Consequently, fiduciary law also indirectly led to the creation of fundamental differences between shareholders and directors with respect to ‘competence, expertise and power’.<sup>232</sup> Accordingly, the trust enjoyed by directors under the fiduciary law led to the notion that directors are indisputably looked upon as being more experienced than the shareholders who appoint them, since shareholders would generally not appoint someone who would work against them. In this regard, shareholders are aware that if directors maximise company profits, dividends can be declared, meaning that shareholders ultimately benefit. In this respect, it is customary in today’s business context, as permitted by the English Companies Act 2006, not to draw up an objects clause to ensure that directors can carry out all acts necessary for the benefit of the company, but reference to Section 171 cannot be undermined which stipulates that if an objects clause is enacted, a director is bound to act within the limits of the objects clause. This wide discretion of trust enjoyed by directors,<sup>233</sup> together with their significant level of expertise, also leads to the notion that a fiduciary can delegate their authority if the company can ultimately benefit from such delegation.<sup>234</sup>

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<sup>232</sup> Alan Wertheimer, *Exploitation* (2<sup>nd</sup> edn, Princeton University Press 1999) 182. Vide also Ross Touche, Desmond Wright and Brian Creighton, *Rights and Duties of Directors* (2<sup>nd</sup> edn, Butterworth and Co. 1991) 9

<sup>233</sup> Samavati (n 177) cited Finn to substantiate this principle on page 63. A fiduciary enjoys a lack of control both from the settlers and from the beneficiaries; therefore, a fiduciary enjoys a lack of control both from the shareholders and from the company

<sup>234</sup> Olthuis Kleir Townshend LLP, ‘A Closer Look at Fiduciary Duty’ <<http://www.oktlaw.com/wp-content/uploads/2014/02/njkCloserLook.pdf>> accessed 20 December 2014

Nonetheless, over time, concern seems to have arisen that the directors will use the excuse of acting in the best interests of the company to be in a position to take very risky actions. Consequently, the enlightened shareholder value (ESV) principle, which was firstly created in the 1980s in the United States, was introduced<sup>235</sup> and incorporated by the Company Law Review Steering Group, or as is widely referred to, CLRSO, in 1999 in the United Kingdom<sup>236</sup> and introduced in Section 172 (1)<sup>237</sup> of the United Kingdom Companies Act 2006, even though this Section primarily entails that the best interest of the company shall be the first interest to be duly protected. This principle, the term which was invented by Michael Jensen,<sup>238</sup> entails that the directors must do their job properly, and shall not take part in any opportunistic behaviours because they are directly accountable to shareholders.<sup>239</sup> Keay believes that this principle has proven to be important, as it protects shareholders. As a result, it seems to apply fiduciary duty as defined in agency law. However, other scholars have voiced their opposition to the adoption of the ESV principle for three reasons. Firstly, they believe that it focuses on a single objective rather than on the best interests of the company as a whole; secondly, it pushes directors to focus only on the company's profits to prove to the shareholders that they are acting in their best interest ; and thirdly, directors may encounter difficulty in interacting with other stakeholders, as shareholders may become suspicious of such interactions.<sup>240</sup> Hence, certain legal scholars believe that the ESV principle needs to be applied with reference to the principle of corporate social responsibility principle (CSR), which requires that the stakeholders'

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<sup>235</sup> Andrew R. Keay, *The Enlightened shareholder value principle and corporate governance* (1<sup>st</sup> edn, Oxford: Routledge, 2012) 15

<sup>236</sup> Ibid., 29. Vide also Shuangge Wen and Jingchen Zhao, 'Exploring the Rationale of Enlightened Shareholder Value in the realm of UK Company Law – The Path Dependence Perspective' (2011) 14 *International Trade and Business Law Review*, 153 - 173

<sup>237</sup> Vide Section 172 (1)

<sup>238</sup> Keay (n 235) 62

<sup>239</sup> Ibid., 21

<sup>240</sup> Ibid., 40

interests are also taken into consideration by directors when acting in the best interests of the company. Stakeholder interest has been at the forefront of discussions for several years. Although the CSR principle is important in itself, Keay is not a full believer in the notion that directors should take stakeholders' interests into consideration when applying their fiduciary duty. Although he does not undervalue the stakeholders' interests, he is of the opinion that the other stakeholders are protected by other laws, giving employees as an example and stating that they are protected by employment law,<sup>241</sup> and therefore do not need to be protected to the same extent as shareholders. Keay also recognises that the ESV principle can work against the CSR principle, such as when directors decide to cut costs to maximise shareholder profit; in this case, they may not be taking the interests of the other stakeholders into consideration, because, for example, employees may be made redundant to achieve the savings.<sup>242</sup> Nevertheless, other writers firmly believe that the ESV principle should be construed in light of the creation of the CSR principle, in which the interests of every stakeholder are taken into account rather than only looking at the shareholders' interests.<sup>243</sup> Friedman<sup>244</sup> and Jensen argue that taking note of the interests of the stakeholders is important for the long-term benefit of the company, which will in turn result in a profit for shareholders.<sup>245</sup> Crowther and Aras go one step further on this subject by declaring that the application of the CSR principle ultimately improves corporate reputation, which in return:

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<sup>241</sup> Ibid., 36

<sup>242</sup> Ibid., 30

<sup>243</sup> A simple definition of the CSR principle is provided by David Crowther and Guler Aras, 'Corporate Social Responsibility' (2008) 9 <<https://www.kantakji.com/media/3473/z126.pdf>> accessed 10 June 2018 and Len Sealy, 'Directors' "Wider" Responsibilities – Problems Conceptual, Practical and Procedural' A.U.L.S.A. conference, Monash University, 25 August 1987, 164 <<http://www.austlii.edu.au/au/journals/MonashULawRw/1987/7.pdf>> accessed 15 July 2018. Vide also Larry E. Ribstein, 'Fencing and Fiduciary Duties' Illinois Law, Behavior and Social Science Research Papers Series Research Paper No. LBSS11-01 Boston University Law Review, Vol. 91, 857

<sup>244</sup> Yohanes E Riyanto and Linda A. Toolsema, 'Corporate Social Responsibility in a Corporate Governance Framework', (SSRN, 2007) <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=987962](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=987962)> accessed 20 July 2018

<sup>245</sup> Keay (n 235) 62

‘improves shareholder value [...] inspires confidence in investors [in the case of listed companies] which in turn leads to a higher stock price for a company [...] more influential on legislative and regulatory governmental decision-making’.<sup>246</sup>

Accordingly, they believe that corporate behaviour has an effect not only on stakeholders and shareholders, but also on the entire economy of the company.<sup>247</sup>

Therefore, after analysing the ESV and the CSR principles, it is noted that the broad discretion and power enjoyed by directors through the application of their fiduciary duty can only be enjoyed within the application of the ESV principle and the CSR principle in today’s interpretation of the business context. Stakeholders’ interests have once again begun to gain prominence and became equally important as the company’s interests. The simultaneous application of both principles also removes the application of the agency law and trust law since these two concurrent principles cannot apply under trust law and agency law as established herein. Under trust law, directors were directly answerable to the people who trusted them with their assets, meaning that the separate legal personality of the company was not recognised at all and the interests of other third parties did not play a role. Under agency law, as well, the ESV principle alongside the CSR principle, could not find ground, because although companies were considered to be a meaningful creation, directors were still directly answerable to shareholders and were not in reality answerable to any other stakeholder or to the company.

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<sup>246</sup> Crowther and Aras (n 242) 61

<sup>247</sup> Ibid., 59

The English Courts have also recently started to apply the fiduciary law only without reference to any other legal term in decisions such as *Shepherds Investments Ltd and Shepherds (Financial) Ltd v Andrew Walters*.<sup>248</sup> The claimant companies claimed damages and an account of profits against their former directors for various breaches of their fiduciary duty, including the setting up of a competing business, diversion of a business opportunity and misuse of confidential information. The defendants had taken the decision to establish a business that they knew would be fairly regarded by both claimants as a competitor and had continued to take steps to bring that rival business into existence, with the result that the investment products offered by the new companies were much similar to the original investment company's products. The Court held the directors to be in breach of their fiduciary duty.

## **2.5 The evolution of the fiduciary duty of directors in the European Union**

Malta joined the European Union (EU) on 1<sup>st</sup> May 2004 with the intent of attaining a harmonised regulation in its laws that covered as many aspects as possible. Developments that have taken place in the EU in the field of company law have influenced Maltese company law and shaped it into its present form, and Malta has transposed all the directives that deal with company law to date,<sup>249</sup> yet the EU has not been a strong influence in the regulation of the fiduciary duty of directors due to the reason that will be presented herein.

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<sup>248</sup> [2006] EWHC 836 (Ch)

<sup>249</sup> A table of the Transposition of Company Law and Anti-Money Laundering Directives in Malta as at 18/01/2012 <[http://ec.europa.eu/internal\\_market/company/docs/official/120118trans-play\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/official/120118trans-play_en.pdf)> accessed 4 March 2014

The EU has not yet defined the specific fiduciary duty of directors, even though corporate mobility in Europe is constantly increasing and debates about the harmonisation of the fiduciary duty of directors are happening.<sup>250</sup> This disinterested approach to harmonising the regulations governing the fiduciary duty of directors has resonated indirectly but very strongly through the years in various papers published by the EU, including a paper published in June 2006 by the European Corporate Governance Forum<sup>251</sup> and the Company Law and Corporate Governance Action Plan published in December 2012,<sup>252</sup> which both papers argued that the fiduciary duty of directors should not be regulated at the EU level. The reason for this lack of proper regulation is because the EU is made up of countries with different beliefs and traditions having their own unique historical and legal backgrounds; consequently, it has always left each member state to regulate this duty according to its own history and beliefs.<sup>253</sup> Accordingly, unlike other areas of company law, the fiduciary duty of directors has not been the subject of an extensive harmonisation programme at the European level.<sup>254</sup> Indeed, in this regard, it is observed that common law systems such as the English system have rigorously regulated this fiduciary duty, but civil legal systems such as the Italian system have not developed this fiduciary duty in as much detail. The differences are because each system has either a one-tier or a two-tier structure. While common law countries such as the United Kingdom provide for broad duties to avoid any type of conflict, in two-tiered systems such as Italy, there is a reallocation of decision-making power to the supervisory board, meaning that the fiduciary

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<sup>250</sup> Carsten Gerner-Beuerle and Edmund-Philipp Schuster, 'The Evolving Structure of Directors' Duties in Europe' (2014) 15 *European Business Organisation Law Review* 191-233

<sup>251</sup> This Forum considered that there was no need to impose any European Union obligation on the boards of directors to certify the effectiveness of internal controls; <[http://ec.europa.eu/internal\\_market/company/docs/ecgforum/statement\\_internal\\_control\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/ecgforum/statement_internal_control_en.pdf)> no 6 accessed 7 June 2014

<sup>252</sup> EU Commission Proposes 2013 Action Plan for Company Law and Corporate Governance, <[https://ec.europa.eu/info/business-economy-euro/doing-business-eu/company-law-and-corporate-governance\\_en](https://ec.europa.eu/info/business-economy-euro/doing-business-eu/company-law-and-corporate-governance_en)>15 accessed 7 June 2014

<sup>253</sup> Klaus J Hopt, 'Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron' (2007) Law Working Paper N°.05/2002, ECGI <[http://bobduncan.dyndns-blog.com/bobd/downloads/Research/Corporate\\_Governance/Hopt2007.pdf](http://bobduncan.dyndns-blog.com/bobd/downloads/Research/Corporate_Governance/Hopt2007.pdf)> 449 accessed 4 March 2014

<sup>254</sup> Gerner-Beuerle and Schuster (n 250)

duty of directors in these jurisdictions is more rigorously regulated through the supervision of other boards rather than through specific statutory regulation.

At the same time, however, the fiduciary duty of directors might seem to have been regulated by the EU in an indirect manner in certain instances. The fiduciary duty of directors has been indirectly regulated from 2003, and more strongly in July 2016 with the enactment of the regulation commonly known as the Market Abuse Regulation.<sup>255</sup> In short, the regulation of this fiduciary duty of directors was achieved through the regulation of market abuse,<sup>256</sup> but this Regulation only applies to listed companies. More specific reference to this Regulation shall be made again in Chapter 4 of this thesis. Market abuse includes insider trading, the unlawful disclosure of inside information and market manipulation, and can only arise in listed companies. All of these particular instances indirectly refer to the fiduciary duty of directors because they refer to a situation in which a director wrongly makes use of inside information, which belong to the company for personal gain or for the gain of other persons. Therefore, this Regulation incidentally requires directors to act in good faith and in the best interests of the company and are under a strict obligation not to carry out any form of market abuse because otherwise the best interests of the company are not safeguarded and an effective mechanism to protect the company will not be in place. A director cannot honour this fiduciary duty if they act against the company, and so it precludes them from engaging in risky behaviour unless they are convinced that such behaviour would place the company in a more prosperous position.

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<sup>255</sup> Regulation (EU) No 569/2014 <<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0596&from=EN>> accessed 10 July 2018

<sup>256</sup> There was the enactment of the EC Directive 86/653/EEC on insider dealing; however, this did not deal with market manipulation. It was only in 2003 that the European Union began to take the issue of the financial market more seriously with the enactment of the Market Abuse Directive 2003. See Alexander Kern, 'The Law of Insider Dealing: A Tale of Two Jurisdictions' <<http://www.rwi.uzh.ch/lehreforschung/alphabetisch/alexander/person/publikationen/2013TheLawofInsiderDealingATaleofTwoJurisdictions.pdf>> accessed 10 June 2014

The EU again indirectly addressed the issue of the regulation of the fiduciary duty of directors when it published the Company Law and Corporate Governance Action Plan in December 2012, through its referencing of the importance of transparency.<sup>257</sup> However, as with market abuse, this paper also tackles these issues with rigidity only with respect to listed companies,<sup>258</sup> largely ignoring small-and-medium enterprises (SMEs), possibly because of their variety between member states.<sup>259</sup> In Malta, however, the economy relies on the formation and functioning of SMEs, as demonstrated in Chapter 1.

## **2.6 The evolution of the fiduciary duty of directors as presented by the international organisations**

Given the rise of international trade over recent years fuelled by technology developments, the development of economic integration processes,<sup>260</sup> the need to create a global governance,<sup>261</sup> and the need to create an international legal system looked on by other legal systems, thus enabling to create a stronger economy<sup>262</sup> in that particular country, the influence of various international organisations has become increasingly significant for the legislators and judiciary of every legal system.

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<sup>257</sup> EU Commission Proposes 2013 Action Plan for Company Law and Corporate Governance (n 252) 14

<sup>258</sup> Ibid., 13

<sup>259</sup> European Commission, 'Annual Report on European SMEs 2015/2016' <[https://ec.europa.eu/jrc/sites/jrcsh/files/annual\\_report\\_-\\_eu\\_smes\\_2015-16.pdf](https://ec.europa.eu/jrc/sites/jrcsh/files/annual_report_-_eu_smes_2015-16.pdf)> accessed 5 December 2016

<sup>260</sup> Maria Gabriela Sterian, 'The Role of International Organisations in the Global Economic Governance – An Assessment' Romanian Economic and Business Review – Special issue 2013, 308 <[ftp://ftp.repec.org/opt/ReDIF/RePEc/rau/journal/WI13S/REBE-WI13S-A32.pdf](http://ftp.repec.org/opt/ReDIF/RePEc/rau/journal/WI13S/REBE-WI13S-A32.pdf)> accessed 4 June 2018

<sup>261</sup> Ramses A. Wessel and Steven Blockmans, 'The Legal Status and Influence of Decisions of International Organisations and Other Bodies in the European Union' published in P. Eeckhout, M. Lopez-Escudero (Eds.), The European Union's External Action in Times of Crisis, Hart Publishing, 2016 <<https://www.utwente.nl/en/bms/pa/research/wessel/wessel112.pdf>> accessed 4 July 2018

However, although international influences may coincidentally pave the way to the regulation of the fiduciary duty of directors in Malta by means of soft law, they are not regarded as an effective means of change in a legal system, for three reasons. First, these international influences are non-binding; therefore, any country may decide for themselves whether or not to adopt them. In fact, although some international organisations display their autonomous power, their decisions might be taken into consideration, even if not binding, at the discretion of the country. However, it must also be observed that some other international organisations ‘serve as an *ad hoc* vehicle for a multilateral diplomatic process’<sup>263</sup> whereby the guidelines issued by these international organisations are influencing the EU’s principles, which, in turn, will be imposed on each member state to ultimately create a global economic web.<sup>264</sup> Second, Malta is not a member of every international organisation, but only of four that regulate company law issues in some way:<sup>265</sup> the International Organisation of Securities Commission (IOSCO<sup>266</sup>); the International Monetary Fund (IMF);<sup>267</sup> the World Business Council for Sustainable Development (WBCSD<sup>268</sup>); and the International Finance Corporation. Third, while all international organisations speak very loudly about the importance of corporate governance for better investor protection and financial resilience, none of these organisations specifically addresses the fiduciary duty of directors in the context of company law.

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<sup>263</sup> Ibid.

<sup>264</sup> Ibid.

<sup>265</sup> A full list of international organisations can be accessed via the following link: <<https://www.icaew.com/library/subject-gateways/corporate-governance/organisations>> accessed 4 May 2018

<sup>266</sup> Malta Financial Services Authority <<https://www.mfsa.com.mt/pages/viewcontent.aspx?id=22>> accessed 2 March 2018

<sup>267</sup> International Monetary Fund, Stronger Emerging Market Corporate Governance Enhances Financial Resilience, 29 September 2016

<<https://www.imf.org/en/News/Articles/2016/09/27/AM16GFSRCH3Emergingmarkets>> accessed 10 May 2018

<sup>268</sup> WBCSD <<https://www.wbcsd.org/Overview/About-us>> accessed 10 May 2018

## 2.7 Conclusion

The analysis in this chapter has shown that the legal donors of the Italian and English legal systems have a common heritage in Roman law and are thus linked. It is also clear that the fiduciary duty through the application of trust has always been the core principle in both legal systems. Accordingly, each system gives prominence to the trust that exists between two persons – in this case, the director and the company – without undermining the interests of other interested parties and also the strong belief placed by one person in the other that deceit will never take place. Moreover, under each of these systems, directors ought to be fully aware that the cost of disloyal behaviour is not limited to a material loss suffered by the directors and the company, but to the fact that such behaviour leads to the trust and honour enjoyed by the directors in society to be forever tarnished.

However, on a closer inspection, it can also be seen that each legal regime has developed and applied its principles in unique ways. The Italian legal system has mainly applied mandate law, which is fundamentally different from agency law with respect to its relationship with third parties. It is also very different to trust law because the former implies a deed of incorporation while the latter does not. By contrast, the English legal system applies trust law in a distinctive business context in which companies were mainly unincorporated, whereas agency law was triggered following the growing importance of the incorporation of companies and it was only through the full application of fiduciary law that the principle of the separate legal personality of the company was applied. These noticeable divergences have led to varied interpretations of the fiduciary duty of directors, as we will see later.

These discrepancies might lead to the assumption that the EU or the relevant international organisations might have felt the need to regulate the fiduciary duty of directors, but neither of them has ever been able to regulate the fiduciary duty of directors until the present date, mainly due to the differences in the legal systems that exist between the countries that form the EU and the international organisations.

## **Chapter 3. The development of the fiduciary duty of directors in Malta**

### **3.1 Introduction**

The purpose of this chapter is to examine the development of the fiduciary duty of directors under the Maltese corporate law by identifying the key characteristics and determinant factors that have influenced legislators and the judiciary in Malta when applying the Italian and English legal systems.

It will demonstrate that the factors identified in Chapter 1, namely the historical, societal, cultural and political factors, together with familiarity with the law, prestige and economic desire have greatly influenced the statutory and judicial changes exhibited by the Maltese legal system throughout the past two hundred years.

It will show how the historical, cultural, societal factors and familiarity with the law have been influential both for legislators and for the Maltese judiciary from the very beginning. These factors led to the regulation of the fiduciary duty of directors being highly influenced by the Italian civil legal system since this fiduciary duty was, accordingly, entirely regulated by the law of mandate. In this regard, reference will be made to Sir Adrian Dingli, who was the main legislator on the Commission that was able to compile, for the first time, the mandate provisions under the Maltese legal system. In fact, this Commission was appointed by the British Government with the aim of enacting laws suitable for the country. A comprehensive study from the nineteenth century onwards, and consequently from the date that Sir Adrian Dingli enacted these mandate provisions, shall be presented. This chapter shall also show that these

provisions enacted by this Commission remained in force with respect to the regulation of the fiduciary duty of directors until the year 2003, and that these provisions have not undergone any important amendments until the present date.

However, at the same time, this chapter will also contend that the same factors that influenced the Maltese legislators and judiciary to consult the Italian legal system also paved the way for them to begin consulting the English legal system from the 1940s onward. This analysis will also provide the answers as to why a system of statute law completely based on the English legal system could not be fully endorsed by the Maltese legislators until the year 2003, despite various different scattered provisions being enacted by Maltese legislators in the 1962 Commercial Ordinance and the 1995 Companies Act. The present study will also demonstrate that, in general, the Maltese judiciary nevertheless began to make reference to the English legal system when interpreting the fiduciary duty of directors from the 1940s onward as opposed to adopting the more resilient statutory approach, with the result that the majority of the Maltese judiciary felt the need, due to the economic and prestige factors, to depart from the statutory development.

### **3.2 The application of mandate law in Malta**

From a statutory point of view, the law of mandate, which traces its history back to Roman law, was indisputably applicable to the regulation of the fiduciary directors' duty in Malta from the time of the very first enacted Commercial Ordinance in Malta in 1857 until 2003. This first Commercial Ordinance stated that directors were considered as mandataries of the partnership

as well as of each and every partner, and this approach was affirmed by the Maltese Courts in the early judgment *Francesco Saverio Musu' v Vincenzo di Saverio Vella et.*<sup>269</sup>

However, under the 1857 Ordinance, reference to the law of mandate as enacted under the French legal system was resorted to because specific provisions of the law of mandate had not yet been enacted under the Maltese legal system, since there were no legislators in Malta capable of completing such a task, who have tried to enact these provisions but failed. The specific mandate provisions were enacted in Malta by a Commission headed by Sir Adrian Dingli some thirteen years after the enactment of the Commercial Ordinance 1857. Indeed, numerous failed attempts had been made to enact the mandate provisions and the whole of the Maltese Civil Code 1870 before the appointment of Dingli's Commission;<sup>270</sup> but only the Commission was able to successfully consolidate this Code.<sup>271</sup> The British government trusted Dingli with this important task because, although it knew that Dingli himself was keen to defend Italian,<sup>272</sup> the Government also had great respect for Dingli, who had been previously appointed to various important and influential positions, first as Crown Counsel in 1854, and thereafter as Chief Justice of Malta. He was later appointed to form part of the Commission to consolidate the Civil Code in the 1860s.<sup>273</sup> He was also popular with those who were devoted to defending Italian culture,<sup>274</sup> thus clearly highlighting the historical and cultural factors rooted in the Maltese legal system at that time. His task was therefore made easier, not only because

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<sup>269</sup> Vol. XII B p 527 (11/11/1890)

<sup>270</sup> Hilda I. Lee, 'British Policy towards the Religion, ancient Laws and Customs in Malta 1824-1851' (1964) 4(1) *Melita Historica: Journal of the Malta Historical Society* 1-13. Lee noted that every attempt failed and nothing was done until the appointment of Sir Adrian Dingli

<sup>271</sup> Maltese History and Heritage <<https://vassallohistory.wordpress.com/the-legal-system/>> accessed 4 August 2015

<sup>272</sup> Palmer (n 2) 568

<sup>273</sup> *Ibid.*, 532. He also cited Biagio Ando' et al. to further prove his argument

<sup>274</sup> *Ibid.*, 568

he was a highly intellectual person, but also because he was highly respected by everyone involved.<sup>275</sup>

Dingli's Commission divided the Maltese Civil Code 1870 into two parts. He first consolidated Ordinance VII of 1868, which dealt with the law of things what is known under English law as the law of property. This Ordinance was promulgated on 11<sup>th</sup> February 1870, and part of it included the mandate provisions under Title XVIII,<sup>276</sup> the provisions of which were copied from the Italian Civil Code 1865.<sup>277</sup> He later consolidated Ordinance I of 1873 concerning the law of persons, which was promulgated on 22<sup>nd</sup> January 1874. This entire Civil Code is still used today, and only minor amendments have been made to the mandate provisions to keep pace with broader changes,<sup>278</sup> without changing their interpretation or application.

Accordingly, from a statutory point of view, trust law or agency law as defined under the English legal system never made its way into the Maltese legal system with respect to the regulation of the fiduciary duty of directors. Although the Maltese statutory company law never made any references to trust law, it did take a clear stand with regard to agency law. From the enactment of Ordinance XIII in 1857,<sup>279</sup> through Act XXX of 1927<sup>280</sup> to the Commercial Code of 1942,<sup>281</sup> agents and directors were considered as two distinct bodies, because they all

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<sup>275</sup> Ibid 568

<sup>276</sup> Chapter 16 of the Laws of Malta <<http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8580>> accessed 2 February 2015

<sup>277</sup> Marco Loos and Odavia Bueno, *Principles of European Law: Mandate Contracts* (1<sup>st</sup> edn, Oxford University Press 2013) 145

<sup>278</sup> Biagio Ando and David Zammit, 'A Happy Union?: Malta's Legal Hybridity' <[https://www.academia.edu/2083635/\\_A\\_happy\\_union\\_Maltas\\_legal\\_hybridity\\_with\\_B\\_Ando\\_Catania\\_and\\_D\\_Zammit\\_Malta\\_](https://www.academia.edu/2083635/_A_happy_union_Maltas_legal_hybridity_with_B_Ando_Catania_and_D_Zammit_Malta_)> accessed 1 July 2014

<sup>279</sup> Vide Article 62

<sup>280</sup> This Act did not alter the definition of 'director' presented under Ordinance XIII 1857

<sup>281</sup> Vide Article 155

stipulated that a company shall be managed by agents or directors. Various Maltese judges and magistrates, together with several legal scholars, also attempted to differentiate between these two bodies of laws by applying them to different corporate scenarios, and one of the pioneers in the Maltese legal field, Professor F. Cremona, draws a distinction between these two laws by establishing that:

‘in their internal dealings with the company, directors should be classified as mandataries of the company, and that in their dealings with third parties they should be considered as agents thereof’.<sup>282</sup>

Cremona was one of the first writers to write about companies in Malta, and his works are highly regarded by the Maltese judiciary and other legal scholars and are cited frequently. Cremona’s established principle was later applied by the Maltese Courts in numerous judgments.<sup>283</sup> Nevertheless, he did not deal with the interpretation of the fiduciary duty of directors as construed under mandate law in great detail.<sup>284</sup>

However, other Maltese legal scholars and the Maltese Courts<sup>285</sup> have not drawn any distinction between agency law and mandate law, but instead opted to use both laws

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<sup>282</sup> F. Cremona, *The Law on Commercial Partnerships in Malta* (1967)

<sup>283</sup> *John Veglio v Catherine Camilleri Catherine* 22/01/1973 (Court of Appeal); *Galea v Milica Micovic noe* 19/11/2001 (Court of Appeal) Cit Nru. 271/93 GV; *Advocate Doctor Anthony H Farrugia as a special mandatary of the minors Fabienne Carbone and Rowan Carbone v Vernie Carbone for and on behalf of various companies and Agostino sive Winston Carbone, together with Advocate Dr. Eric Mamo, for and on behalf of other companies* 30/05/2001 (Court of Appeal) Cit. Nru. 82/1990/1; *Video On-Line Limited v Ian Giles* 25/02/2004 (Court of Appeal) Cit Nru. 339/2002/1

<sup>284</sup> Times of Malta, ‘Book Review: Definitive Publication’ <<https://www.timesofmalta.com/articles/view/20071220/publication.189339>> accessed 5 December 2014

<sup>285</sup> *Advocate Doctor Ian Refalo noe et v Albert David Boweck et* 18/03/1986 (First Hall Civil Court); *Deirdre and John Cachia v Gaba Diamonds Company Limited* 28/11/2003 (Court of Appeal) Cit. No. 2227/1998/1; *Enemalta Corporation v Vella Group Limited and John Mary Vella* 08/06/2006 (Court of Appeal) Cit Nru. 1837/2004/1; *Executive Services Ltd v Therese Agius* 14/12/2001 (Tribunal for Small Claims) Cit Nru. 1062/2001/1

interchangeably, and even the Maltese legal writer Professor Andrew Muscat establishes that ‘at law, agency is a species of mandate’.<sup>286</sup> However, whenever agency law and mandate law are used interchangeably, mandate law as enacted under the Maltese Civil Code 1870 has always been applied to interpret the fiduciary duty of directors, suggesting that agency law has always been sited within the limits of the mandate law, and not in the way in which agency law was applied and interpreted under the English legal system.

### **3.2.1 Reasons to consult the Italian mandate law**

#### ***3.2.1.1 Factors that influenced legislators***

Maltese legislators were strongly influenced by four main factors – historical, cultural, societal and a familiarity with the foreign legal system in question. The following sections will review them to facilitate a full understanding of the extent of their effectiveness under the Maltese legal system. Historical, cultural and societal factors will be grouped under one heading whereas familiarity with the law will be dealt under another heading.

##### ***3.2.1.1.1 Historical, cultural and societal factors***

Sir Adrian Dingli was surely influenced by the strong linguistic link between Malta and Italy, which even existed before Dingli’s time. . One of the main factors that drove him to consult the Italian legal system was the strong connection to Italian felt by the Maltese elites, along with Dingli’s own personal desire to defend the language. Dingli was hence very much influenced by the historical, cultural and societal factors felt by the Maltese islands at that time

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<sup>286</sup> Muscat (n 31) 415

and he declared himself to be ‘keen to defend Italian and cultural heritage’.<sup>287</sup> The prominence of Italian in the Maltese islands stems from its first inhabitants who introduced Italian in Malta from southern Sicily around 5000 BCE,<sup>288</sup> who came to Malta due to famine. Malta was subsequently conquered by the Phoenicians around the seventh century BCE, then by the Carthaginian Empire in 400 BCE. Although the Carthaginians did not speak Italian themselves, it continued to be the most important spoken language in Malta. Malta was subsequently conquered by the Roman Empire in 218 BCE and during this time its people were collectively referred to as Quirina, considered the noblest tribe of those times. This reinforced the influence and importance of Italian in the Maltese Islands since they were considered a Roman tribe, and the Maltese were considered full Roman citizens.<sup>289</sup> As a result of this affiliation, Italian became the sole official language of Malta for political and other significant issues, such as the enactment of laws.<sup>290</sup> This Italian influence continued to prosper throughout the Norman occupation between 1091 and 1530.<sup>291</sup> The Italian influence also maintained its dominance during the conquest by the Knights of St John<sup>292</sup> and was so strong that it was not even undermined by the conquest of Malta by the British Empire in 1800, at which time the Maltese Islands fell under the jurisdiction of the British government.<sup>293</sup> Although common law should have found applicability in the Maltese Islands, since common law applies under the English jurisdiction, the Italian influence was so strong in Malta it could not be impaired. This situation led to the issue of a Royal Order 1801 by the United Kingdom government stating that ‘English

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<sup>287</sup> Palmer (n 2) 568

<sup>288</sup> Carmel Vassallo, *The Malta Chamber of Commerce 1848-1979: An outline history of Maltese Trade* (1<sup>st</sup> edn, Interprint the Malta Chamber of Commerce 1998) 3

<sup>289</sup> Antonio Cini, *Origine e Progresso della Lingua Italiana In Malta ossia la Lingua Nazionale Dei Maltesi* (1<sup>st</sup> edn, Catania 1903) 7

<sup>290</sup> *Ibid* 54

<sup>291</sup> Oliver Friggieri, *Storja tal-Letteratura Maltija* (1<sup>st</sup> edn, Valletta, Klabb Kotba Maltin 1979) 79

<sup>292</sup> Cini (n 289) 30

<sup>293</sup> Biagio Ando, *The Role of Judges in the Development of Mixed Legal Systems: The Case of Malta* (2011) 4 (2) *Journal of Civil Law Studies* 11-12 <<http://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?article=1041&context=jcls>> accessed 12 July 2014

laws and Courts of judicature had no jurisdiction over Malta, and Maltese law *in primis*, institutions were not affected'.<sup>294</sup> Consequently, Italian continued to be the sole official language in Malta for the cultural and elite group until the 1940s and continued to be used in the regulation of political and other significant issues. It continued to be used in the civil service, in state schools, in Courts and for the enactment of laws.<sup>295</sup> It retained its position until the 1940s 'as the language of thinking and imagination'<sup>296</sup> that has 'penetrated our most intimate and delicate sentiments of our hearts'.<sup>297</sup>

The Italian influence was so strong during the 1800s that the Maltese language was considered as the language of the common people<sup>298</sup> and not used in the enactment of any laws or the regulation of important issues of the country. Consequently, it never exerted any influence on politics or other significant ideas that regulated the Maltese islands. In this way, these historical, cultural and societal factors have uniquely shaped the Maltese legal system. These three factors accordingly show that the full effectiveness of legal transplantation was hindered until the 1940s by the imposition of the Italian legal system on the Maltese legal system. In fact, although during World War II, the Maltese people wanted to dissociate themselves from Italian culture and language, Italian is still dominant today in the Maltese Islands; this language is taught at schools and the majority of the Maltese people know how to speak and write fluently in Italian. In this respect, it is indeed noted that although Italian had ceased to be the official language of the Maltese islands by the 1940s and Italian culture was no longer the sole

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<sup>294</sup> Ibid 8; Chamber of Advocates, Malta, 'Legal Setup' <<http://www.avukati.org/content.aspx?id=36441>> accessed 12 July 2014

<sup>295</sup> Ibid 65

<sup>296</sup> Ibid 73

<sup>297</sup> Ibid 71

<sup>298</sup> Friggieri (n 291) 73

influence in Malta by that time, the language and culture remain very influential in Malta to this day.

#### ***3.2.1.1.2 Familiarity with the law***

The Commission chaired by Dingli felt it appropriate to consider the Italian civil legal system when enacting the mandate provisions as the law that would regulate the fiduciary duty of directors for three other reasons; reasons that reveal the Commission's familiarity with the approach of the Italian legal system.

First was that the mandate terminology used by legislators from the first Maltese Commercial Ordinance of 1857 implies that a civil legal system was adopted. Indeed, Ordinance No XIII of 1857 had already included references to the word *mandato* in its Italian text when referring to the performance required of directors.<sup>299</sup> This phrase is present under a civil legal system, but absent under the English legal system. Reference to the English legal system would consequently have given rise to difficulties. Accordingly, to avoid disturbing the situation in which the fiduciary duty of directors was already regulated by a civil legal system that seemed to be functioning well, it seemed more appropriate for Dingli's Commission to follow the civil legal system rather than the common system when enacting the mandate provisions and other parts of the Maltese Civil Code 1870. Nevertheless, an interesting point to make is that given that this Ordinance was entirely based on the French Commercial Code of 1807 rather than on the Italian Code 1865, Dingli's Commission might have looked at the French legal system rather than the Italian legal system; however, the direct influence of the Italian legal system

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<sup>299</sup> Vide Article 62

could not have taken place by the time of the enactment of the first Maltese Commercial Ordinance of 1857, as there had not been any Italian Codes enacted by then, but the Italian Civil Code 1865 was enacted by the time Dingli's commission embarked on its project. Moreover, in reality, the French legal system was part of the civil legal system, and greatly influenced the Italian legal system. The influence of the civil legal system also determined how the provisions governing the fiduciary duty of directors were enacted and regulated. The French Commercial Code 1807 did not directly regulate the fiduciary duty of directors, but this duty was regulated by the French Civil Code of 1804, which incorporated the mandate provisions.<sup>300</sup> The French Civil Code influenced the Italian Civil Code of 1865, Italy's first Code as a unified state, which also included the mandate provisions.<sup>301</sup> Consequently, the first Italian Commercial Code, which was enacted in 1865 and which is also based on French law, only stipulates that companies shall be administered by directors who shall be considered as mandataries and whose duties shall be governed by the Italian Civil Code 1865 mandate provisions.<sup>302</sup> Accordingly, the Italian Civil Code 1865 dealt with the mandate rules rather than the various Italian Commercial Codes that had been enacted throughout the years until the 1940s. This particular reference to the Italian legal system led to the way the fiduciary duty of directors was regulated in Malta as Dingli's Commission applied the same reasoning. Hence, until the enactment of Article 136 A in the Companies Act in 2003, the fiduciary duty of directors was regulated by the Maltese Civil Code 1870 through the mandate provisions, rather than by any Commercial Ordinances or Codes that had been enacted in Malta throughout the years.

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<sup>300</sup> Aldo Petrucci, 'La Codificazione del Diritto Civile negli Stati Italiani preunitarie del Codice Civile Italiano del 1865' <<http://www.romanlaw.cn/sub2-22.htm>> accessed 5 August 2015

<sup>301</sup> Adriano Dingli, *Annotazioni e Foni All'Ordinanza VII 1868*, article 1643, 116

<sup>302</sup> Codice di Commercio 1882 <<http://www.antropologiagiuridica.it/codecomit82.pdf>> accessed 5 December 2014. Article 121 states that the company shall be administered by directors who are considered as mandataries, and who can be shareholders or otherwise

Another reason which explains why the Commission seems to have been more confident in resorting to the Italian legal system is because it is codified, and therefore easier to access. Indeed, it seems that Dingli led his Commission to consult only codified laws, something Dingli himself acknowledged in his notes, entitled '*Appunti*',<sup>303</sup> that the foreign sources of law he consulted were primarily the Roman law, the Code Napoléon, the Austrian Code, and the Codes of various Italian states, along with a few references to other authors, namely Troplong,<sup>304</sup> Pothier<sup>305</sup> and Smith.<sup>306</sup> He acknowledged that the Italian Civil Code of 1865 was consulted with respect to the specific enactment of the mandate provisions under the Maltese Civil Code 1870. The English legal system was based on case law with respect to the regulation of the duties of directors until 2006. Reference to case law would have been more difficult, since it would have been scattered across various judgments that might not have always been easy to access. The English legal system only codified the duties of directors, including their fiduciary duty, with the Companies Act 2006.

One final reason that might have led Dingli's Commission, and more importantly Dingli himself, to consult the Italian legal system specifically with respect to the regulation of the fiduciary duty of directors through the mandate law was that he might have been concerned with the application of the law of precedent, which is rigorously applied under the English legal system. He may have been concerned that if the precedent principle was to form part of the Maltese system, it would be impossible to achieve any remedy in cases of total injustice. In fact, one might argue that the law of precedent on which the English legal system is based is unfair, as it stipulates that the judge's decision is binding on other judges and authorities faced

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<sup>303</sup> Dingli (n 301)

<sup>304</sup> Ibid.

<sup>305</sup> Ibid.

<sup>306</sup> Ibid.

with the same or similar factual situations. By contrast, case law under the civil law system is considered to be persuasive but not binding. Hence, the civil legal system gives the judiciary the opportunity to consult both the enacted law and any available case law on the subject matter, but at the same time grants them total freedom to draw their own conclusions. Therefore, a case that had been unjustly decided by one judge would not be automatically binding on other judges and authorities. Such legislative reasoning seems to hold ground even more given that Dingli followed the English legal system with respect to criminal procedure,<sup>307</sup> since the English legal system seemed more just, equitable and impartial than the civil law system in that particular field.<sup>308</sup>

### ***3.2.1.2 The judicial factor and the influence of prestige and economic factors***

The judicial factor is an influence in itself; however, until the 1940s, it was very much tied to the historical, cultural and societal factors, together with the familiarity with the law, and the Maltese judiciary only made reference to the Maltese mandate statutory provisions as influenced by the Italian system and also delivered these judgments in Italian until such date. Such approach might have arisen because the judiciary might have been of the opinion that it could only obtain the prestige it strived for through strict observance of the tight historical links to the Italian legal system, since they perceived the Italian legal system and its history to be superior to the English legal system; in their minds, the economic factor was, therefore, only a subsidiary factor until that time.

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<sup>307</sup> Palmer (n 2) 567

<sup>308</sup> Under the common legal system, the principles of habeas corpus and trial by jury are strictly abided by whereas under the civil legal system, these two principles are almost non-existent

### 3.3 The application of fiduciary law in Malta

Although the law of mandate was the first to be explicitly applied with respect to the regulation of the fiduciary duty of directors, the influence of the fiduciary law from the very first enacted Commercial Ordinance 1857 in Malta cannot be understated since it has created the concept of the fiduciary duty that is to be strictly observed by directors.<sup>309</sup> This fiduciary duty was, until 2003, generally interpreted within the stringent boundaries of the mandate law as much as was allowed by the Maltese statutory legal system and by the Maltese judiciary. However, from the 1940s onwards, certain specific scattered provisions were enacted in the Maltese Commercial Ordinance 1962 and the Maltese Companies Act 1995, which explicitly regulated certain aspects of this fiduciary duty and superseded the application of the mandate provisions. These provisions were directly influenced by the English statutory legal system, specifically by the 1948 and the 1985 Companies Acts, and could not be fully interpreted within the meaning of mandate law. Many Maltese judges and magistrates were thus generally applying the fiduciary law as applied under the English legal system, as expressed (for instance) in the judgment *Emanuel Chircop pro et noe v Carmel sive Charles Busuttil et*,<sup>310</sup> but still within the limitations imposed by mandate law.

This confusing situation involving the attempted simultaneous application of two distinct legal systems was only finally settled in 2003, with the enactment of Article 136 A of the Maltese Companies Act 1995, in which the fiduciary duty of directors as interpreted by the English legal system was referred to comprehensively, without any references to the Italian legal

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<sup>309</sup> Maltese judgment *Messina v Galea*, decided on 5<sup>th</sup> January 1881, which specifically asserts that the fiduciary law as arising under Roman law has from the beginning been integrated into the Maltese legal system. The interpretation of the fiduciary duty is further detailed in Chapter 4

<sup>310</sup> 12/11/2013 (First Hall Civil Court) Cit Nru 1223/1997/1

system and the mandate law. This also gave rise to the enactment of a statutory set of rules intended to apply only to directors; this can be contrasted with mandate law, which applies to any relationship that may exist between two persons, meaning that the application of mandate law is therefore not limited only to the relationship between directors and companies.

This Article was supplemented a year later with the general fiduciary provisions in the Maltese Civil Code 1870 of Articles 1124 A and B. These two provisions also apply the fiduciary duty, but were entirely influenced by the Roman legal system (vide Chapter 4), which suggests that legislators in Malta had felt the need to reincorporate the civil legal system. Reference to the English legal system could not be made because the English legal system does not provide for such a circumstance. The enactment of these two provisions shows the stance taken by the Maltese legislators to try and ensure that no one can escape from their responsibilities. These provisions were enacted with the specific aim of ensuring that any person who does not hold the title of director, but may still affect the management of the company and shall therefore be considered a director, can be still held liable if Article 136 A proves to be insufficient to cover them. Accordingly, these two Civil Code provisions not only apply to directors, but also to any other person who holds a fiduciary position, including any person who might try to shield themselves from responsibility by claiming not to hold the title of director. However, these provisions only apply as a secondary set of rules to Article 136 A, and should therefore only be analysed within their strict application (vide Chapter 4), and so will not be examined in the analysis provided in this Chapter.

### 3.3.1 Reasons to consult English fiduciary law

#### 3.3.1.1 Factors that influenced legislators

Maltese legislators continued to be strongly influenced by four main factors – historical, cultural, societal and a familiarity with the foreign legal system in question even after the 1940s. The following sections will review them to facilitate a full understanding of the extent of their effectiveness under the Maltese legal system. Historical, cultural and societal factors will be grouped under one heading whereas familiarity with the law will be dealt under another heading.

##### 3.3.1.1.1 Historical, cultural and societal factors

Following the brutal assaults by Benito Mussolini's Regia Aeronautica and the German Luftwaffe during World War II and with Britain as their sole protector, the United Kingdom replaced Italy as the dominant influence in the Maltese people's hearts.<sup>311</sup> This was particularly evident in 1954, when the Maltese Government appointed a Commission to draft new provisions to regulate the fiduciary duty of directors and limited liability companies and this Commission decided to take the English developments into consideration.<sup>312</sup> The provisions of limited liability companies as understood today were drafted for the first time during that period.<sup>313</sup>

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<sup>311</sup>Arnold Cassola, 'Italo-Maltese Relations' (2012) 5(1) Mediterranean Studies 17; The Daily Chronicles of World War II, 'Mussolini Bombs Malta Island Fortress (*Malta, Central Mediterranean · June 11, 1940*)' <<http://ww2days.com/mussolini-bombs-malta-island-fortress.html>> accessed 15 July 2014

<sup>312</sup>Neil Wilson and Carolyn Joy, *Malta and Gozo* (4th edn., Lonely Planet Publications 2010) 25-27; Vassallomalta.com, 'Self-Government and Courage 1921 – 1945' <<http://www.vassallomalta.com/Dates/British3.htm>> accessed 15 July 2014

<sup>313</sup> The Commercial Partnerships Ordinance, 'Chapter 168 of the Laws of Malta' <<http://justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8688>> accessed 10 July 2014. This Ordinance was superseded in 1995 with the enactment of the Companies Act

Such historical factor consolidated the cultural and societal factors, such that English began to replace Italian, and it started to be considered an official language of the Maltese islands, together with Maltese, from the 1940s. The Maltese Parliament subsequently officially assented to English being made the official language of Malta when it gained its independence in 1964 with the enactment of the Constitution of Malta.

#### ***3.3.1.1.2 Familiarity with the law***

Maltese legislators also made exclusive reference to the English legal system and its statutory enactment of the fiduciary duty of directors for one important legislative reason: legislators were becoming more familiar with the English legal system than the Italian legal system at that time, as shown by the Commission 1954 mentioned herein which decided to take into consideration the English system to enact the new provisions. They considered the English system to be more practical, even from an economic perspective. Indeed, the old provisions concerning limited liability companies in Malta, which included the implications for the fiduciary duty of directors within the interpretations of the law of mandate, were described by the Commercial Partnerships Law Reform Commission in 1954 as ‘totally inadequate and, in a way, are a serious handicap to the desired development of trade by companies’.<sup>314</sup> The Commission was appointed by the government to revamp the commercial laws to ensure that Malta was regulated by the latest, most up-to-date laws. The Commission felt that the English legal system was more suitable for the advanced, sophisticated and complex financial and commercial environment that had been created over time,<sup>315</sup> a Maltese sentiment fuelled by

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<sup>314</sup> See section 26 of the report published by the Commission

<sup>315</sup> Ibid.

London attaining the status of an important financial centre<sup>316</sup> in the EU.<sup>317</sup> The United Kingdom has been able to enact laws throughout subsequent years to accommodate the foreign exchange business,<sup>318</sup> keeping pace with developments within the EU and more broadly. This sentiment, echoed by the 1954 Commission, continued to be strong in Malta even with the appointment of the 1992 Commission,<sup>319</sup> which was appointed to enact the 1995 Companies Act, and later, with the specific enactment of Article 136 A of the Companies Act 1995.

However, the exclusive regulation of the fiduciary duty of directors could not take place in Malta before 2003 due to one main problem. Until then, specific statutory reference to the English legislation governing the statutory regulation of the fiduciary duty of directors proved to be difficult since this particular field of law was not regulated by any provisions of English statute law that could be easily accessed and referred to. Consequently, until 2003, the fiduciary duty of directors in Malta continued to be regulated primarily by the Italian civil legal system through the law of mandate, except for those scattered provisions in the 1962 Commercial Ordinance and the 1995 Companies Act. Nevertheless, as soon as the statutory regulation of the fiduciary duty of directors began to be discussed in the United Kingdom, Malta followed suit, which led to the enactment of Article 136 A of the Companies Act in 2003. There were no parliamentary debates on the matter nor any other prior discussions until its enactment, and the government of the day only stated in 2003 that it was time for a specific list of duties of directors to be enacted.<sup>320</sup>

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<sup>316</sup> Muscat (n 31) 57

<sup>317</sup> Peter Dicken, *Global Shift: Reshaping the Global Economic Map in the 21st Century* (4<sup>th</sup> edn., SAGE Publications India 2004).

<sup>318</sup> *Ibid.*, 465

<sup>319</sup> Muscat (n 31) 26

<sup>320</sup> Governmental debate 2003 accessed from the National Library situated at Valletta, Malta

### 3.3.1.2 *The judicial factor and the influence of the prestige and economic factors*

The majority of the Maltese judiciary, which judicial factor considered as a factor in itself, felt the desire to make reference to the English legal system from the 1940s onwards, mainly due to the economic and prestige factors<sup>321</sup> represented by the English legal system. Should the historical, cultural and societal factors, together with the familiarity with the law have been an influential factor for this part of the Maltese judiciary, these judges and magistrates would have undoubtedly opted to continue making reference to the Italian legal system rather than taking the time to understand another foreign legal system and looking into its unique judgments and legal opinions. Hence, most of the Maltese judiciary seems to have started to believe that it was only through providing better economic conditions that they could enhance their prestige. Historical, cultural and societal factors and their familiarity with the law would not lead to the same level of prestige among their peers, as a country would only consult another country if such consultation would result in a benefit (such as economic growth and the importance of democracy); therefore, the historical aspects of one country would only be a factor of interest up to a certain level. In fact, as President Santomero at the Pennsylvania Economic Association Annual Conference stated, a good economy ‘is an important goal for a democratic society’.<sup>322</sup>

This economic and prestige influence can be triggered because the 1812 Maltese Commission provided that the Maltese judiciary can only be removed if a resolution was approved by a two-

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<sup>321</sup>Stephen B. Burbank and Barry Friedman, *Judicial Independence at the Crossroads: An Interdisciplinary Approach*, Chapter Title: "Judicial Independence: How Can You Tell It When You See It? And, Who Cares?" (1<sup>st</sup> edn, Sage Publications Inc, 2002) <<https://scholar.princeton.edu/sites/default/files/ccameron/files/cameron.judicialindependence.pdf>> accessed 20 June 2018

<sup>322</sup> Anthony M. Santomero, Knowledge is Power: The Importance of Economic Education, Based on a speech given by President Santomero at the Pennsylvania Economic Association Annual Conference, West Chester University, West Chester, PA, on May 30, 2003 <<https://philadelphiafed.org/-/media/research-and-data/publications/business-review/2003/q4/brq403as.pdf>> accessed 25 May 2018

thirds majority of the House of Parliament.<sup>323</sup> Thus a judge cannot be removed on the basis of a judgment that is incorrectly decided, but only if a serious concern arises such as proven misbehaviour or proven inability to perform the functions of their office, but no Maltese judge has ever been removed from office until to date on such grounds. Therefore, given this security of tenure, the judiciary has the freedom to apply those factors that they deem appropriate in accordance to their own judgment. Moreover, Professor Kevin Aquilina, one of Malta's most authoritative legal academics, asserts that even if a magistrate or judge was to be removed from office, this motion could probably be challenged, and the judge or magistrate in question would have to be reinstated,<sup>324</sup> suggesting even more that the Maltese judiciary is free to apply the factors it deems appropriate. If judges and magistrates are not removed from office, the Maltese Constitution provides a mandatory retiring age for the Maltese judiciary, currently set at sixty-five.

The prestige and economic factors led to this part of the Maltese judiciary to apply the English legal system, not only when clear provisions were enacted based on the English legal system, but also when they found themselves faced with a lacuna. In fact, this specific application was made in the Maltese judgment *Giovanni Anastasi noe v Kaptan Serafino Xuereb M.B.E et*,<sup>325</sup> in which the Court pointed out that Maltese law on the regulation of companies was still not inadequate, and that reference to other legal systems was therefore crucial, particularly to the English legal system, partly because, at that time, companies were being formed in a way that

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<sup>323</sup> Barry Hough and Howard Davis, *Coleridge's Laws: A Study of Coleridge in Malta*, With an Introduction by Michael John Kooy (1<sup>st</sup> edn., Cambridge Open Book Publishers 2010)

<sup>324</sup> Kevin Aquilina, *Indepth: Law faculty dean believes more autonomy needed in selection, removal of judiciary*, (2017) Malta Independent <<http://www.independent.com.mt/articles/2017-12-15/local-interviews/INDEPTH-Judge-s-comment-on-UK-law-firm-s-opinion-in-Daphne-case-premature-Kevin-Aquilina-6736182642>> accessed 3 July 2018

<sup>325</sup> 14/06/1951 (Commercial Court)

was modelled on the English legal system, specifically on the Companies Act 1948. In this particular case, the company did not formulate the memorandum and articles of association as it should have. Accordingly, reference to the English legal system was able to shed light on the interpretation of the meetings of the board of directors and the company's management. Other Maltese judges and magistrates also made continuous reference to English judgments in other judgments that they have delivered.<sup>326</sup>

However, at the same time, there were other judges and magistrates who showed through their application and interpretation of statute law that they were still interested in the historical, cultural and societal factors, together with the familiarity with the law (vide Chapter 5). These judges and magistrates presumably were of the opinion that they could still achieve the desired economic and prestige factors through the application of the factors mentioned herein by continuing to apply the Italian legal system.

### **3.4 Conclusion**

The Maltese regulation of the fiduciary duty of directors has been influenced by two different legal systems: the Italian legal system and the English legal system. The Maltese legal system can, therefore, be regarded as an example of the legal transplantation principle.

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<sup>326</sup> These include: *Re Punt v Symons & Co Ltd* [1903] 2 Ch. 506, *Smith & Fawcett Ltd* [1942] Ch. 304, *Industrial Development Consultants Ltd v Cooley* [1972] 1 W.L.R. 443 and *Norman v Theodore Goddard* [1999] B.C.L.C. 1028

To begin with, this fiduciary duty was applied within the terms of the mandate law for various legislative and judicial reasons. However, certain scattered provisions enacted in the Maltese Commercial Ordinance 1962 and the Companies Act 1995 started to change the Maltese legal system since they were derived from the English system. This shows that the factors that influenced the legislative and judicial Maltese legal system when applying the Italian legal system, were being adjusted to apply the English legal system, which influence continued until the enactment of Article 136 A of the Maltese Companies Act 1995. It was also observed that the majority of the Maltese judiciary also began to blend the civil legal system and the common legal system from the 1940s.

## **Chapter 4. The fiduciary duty of directors under the Maltese statutory legal system**

### **4.1 Introduction**

The underlying purpose of this chapter is twofold: first, to examine the Maltese statutory provisions that have regulated the fiduciary duty of directors from the nineteenth century until now; and second, to assess the extent of the influence exerted by the Italian and English legal systems on the Maltese legal system through the manner in which the statutory provisions were enacted in Malta.

This analysis will be divided into four parts. First, the definition of a director is closely examined to better understand which parties are required to abide by the statutory duties that have been enacted over the past two hundred years. Second, it will examine the mandate provisions as enacted under the Maltese Civil Code 1870, since mandate law was the first law to have regulated the fiduciary duty of directors and reference to Maltese *res judicata* judgments, together with the Italian and English statute law, shall also be made. The third part of this study will be based on an examination of Article 136 A of the Maltese Companies Act 1995 since this specific statutory Article has started to regulate the fiduciary duty of directors since 2003 while also making reference to Maltese *res judicata* judgments and to English statute law and judgments. The fourth section will delve into an analysis of Articles 1124 A and B as enacted in the Maltese Civil Code 1870 in 2004 to demonstrate that these two provisions apply to directors as ancillary to Article 136 A of the Maltese Companies Act 1995.

Although *res judicata* judgments shall be continuously referred to throughout this chapter, the analysis will not deliberate over whether the Maltese Courts have rightly or adequately applied the appropriate statute laws; instead, it will simply refer to any interpretations provided by the Courts. Accordingly, the judgments do not deal only with cases between directors and companies; rather, any judgment that sheds light on the interpretation of a particular aspect of this fiduciary duty will be examined.

#### **4.2 History of the definition of a director under the Maltese legal system**

Before examining the statutory fiduciary duty of directors under Maltese law, it is necessary to establish who is considered to be a director under this system. Although Maltese statute law has never delved into the different categories of directors, the basic categories of directors as arising under general corporate principles<sup>327</sup> come to mind and the distinction between executive and non-executive directors shall therefore automatically be referred to. Executive directors are those concerned with the day-to-day management of the company,<sup>328</sup> whereas non-executive directors are only relied upon when their particular expertise is needed, and are usually independent of the company.<sup>329</sup> Both types can be further categorised as *de jure* directors, being those formally appointed to the board of directors.

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<sup>327</sup> Mark Stamp, *Practical Company Law and Corporate Transactions* (3<sup>rd</sup> edn, Sweet & Maxwell 2011) 258

<sup>328</sup> John H. Farrar and Brenda M. Hanningan, *Farrar's Company Law* (4<sup>th</sup> edn., Oxford University Press 1998) 329 and *Relazione Annuale sulla adesione alle raccomandazioni contenute nel codice di autodisciplina delle Società* <sup>quotate</sup> <<http://www.borsaitaliana.it/bitApp/view.bit?target=DocViewerDownload&filename=corporgo%2Fnew%2F9700.pdf>> accessed 5 June 2016

<sup>329</sup> Muscat (n 31) 360 and *Ibid.*

Others, while not formally appointed as directors, may still fall under the definition of a director due to the influence they exert over the company, such as a manager of the company. These people can be considered de facto directors. A de facto director is, accordingly, a person who is not formally appointed to the board of directors,<sup>330</sup> but who still exerts a certain degree of control over the company.

It is also necessary to consider the possible appointment of shadow directors, whose function is to give instructions to the board of directors with respect to the management of the company.<sup>331</sup> The difference between a de facto and a shadow director is that, while a de facto director only acts as they deem appropriate in line with their fiduciary duty, a shadow director may exert a degree of authority over the board of directors<sup>332</sup> but still has to abide by their fiduciary duty. They can thus be considered to have a more onerous fiduciary duty than a de facto executive director, and may be held more accountable for their actions.<sup>333</sup>

The Maltese legal system draws no distinction between categories of directors; consequently, any person who falls under any category of directors shall be required to abide strictly by the fiduciary duty in the same rigorous manner. Until the enactment of the Commercial Partnerships Ordinance 1962, the definition of a director was not explicitly stated in Maltese statute law, although this definition has always been implied indirectly in Article 62 of Ordinance XIII of 1857, the first such Ordinance in Malta. This Article states that the company shall be managed by directors, but does not explicitly delineate who shall fall into this category.

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<sup>330</sup> Muscat (n 31) 363

<sup>331</sup> Vide Section 251, Companies Act 2006  
<[http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga\\_20060046\\_en.pdf](http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf)> accessed 3 December 2015

<sup>332</sup> *Smithton Ltd v Naggar* [2014] EWHC 680 Ch.

<sup>333</sup> *Ibid.*

This approach is copied from the French Commercial Code 1807, which also did not provide a definition of a director, but it only provided under Article 31 that a company shall be administered by mandataries, either for payment or gratuitously, who shall be elected for a definite period of time and who may also be shareholders.<sup>334</sup> Accordingly, if a person were to be appointed for instance as a manager or a sales executive, but also performed the function of managing the company, such a person would be considered a director and would be obliged to abide by the fiduciary duty of directors. Consequently, it transpires that the function of the appointed person, rather than their title, is key. To clarify this statutory provision, recourse to Maltese judgments would have proven valuable, but the Maltese Courts were not presented with any case in which they were obliged to clearly define a director during the period in question.

The same approach continued to be observed under Act XXX 1927 and the 1942 Act,<sup>335</sup> neither of which contained an explicit definition of a director. Statutory provisions still continued to place emphasis on the function of the appointed person rather than their title. While this approach was copied from the Italian Commercial Code 1865<sup>336</sup> and 1882<sup>337</sup> rather than from the French Commercial Code 1807, these two Codes were themselves also influenced by this French Code, with the result that the French and Italian legal systems were consequently based on the same principles and reasoning. Once again, recourse to case law would have furthered the understanding of who should be considered a director, but this issue never came before the

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<sup>334</sup> Code de Commerce, <<http://gallica.bnf.fr/ark:/12148/bpt6k56629t/f10.item.zoom>> accessed 3 December 2015

<sup>335</sup> Vide Article 155

<sup>336</sup> Vide Article 129

<sup>337</sup> Vide Article 121

Courts. Accordingly, the approach taken under the previous Ordinance should be reasonably considered to continue to apply.

A minor revolution was nonetheless observed with the enactment of the Commercial Partnerships Ordinance 1962, in which an explicit definition of a director was included under the statute law for the first time; however, this still did not provide a clear understanding of who was deemed to fall under the category of a director, and emphasis on the function of the appointed person persisted. This amendment was initiated in May 1954, when the government of the day appointed a Commission to enact a new Code to regulate companies. This Commission recommended for the first time the inclusion of a broad definition of a director in the Commercial Partnerships Ordinance 1962. Accordingly, Article 2 of this Ordinance established that a ‘director’ includes ‘any person occupying the position of director by whatever name called’. This definition was inspired by Section 124 (4) of the United Kingdom’s Companies Act 1948, as also stated by the Commission itself,<sup>338</sup> which provides that a ‘director and officer shall include any person in accordance with those directions or instructions the directors of the company are accustomed to act’. This broad definition makes it even clearer that only the function of the appointed person, rather than their title, is important in understanding whether or not a person shall be considered a director. As a result, people appointed, among others, as managers, sales executives or agents may fall under the definition of a director and thus be required to abide by the fiduciary duty attributed to directors if they enjoy any decision-making powers with respect to the management of the company. Once more, however, this non-exhaustive definition was never challenged before the Maltese Courts.

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<sup>338</sup> Report published by the Maltese Commission as found at the National Library Valletta, Malta

With the enactment of the Companies Act 1995, which superseded the 1962 Ordinance, the situation with respect to the statutory definition of a director did not change. Article 2 of the 1995 Act defines a director as ‘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’. Consequently the same approach continued to apply whereby any person who manages the company in any manner shall be considered a director. Again, this approach was influenced by the English legal system, specifically by the Companies Act 1985. This definition remains unamended to date, and again has not come before the Courts.

#### **4.3 The statutory fiduciary duty of directors before 2003**

Until 2003, the fiduciary duty of directors was required to be exercised by directors under mandate law, meaning that the mandate provisions enacted under the Maltese Civil Code 1870 were applied. The directors acted as mandataries in the interest of the company, which was considered to be the mandator. An indirect reference to the application of the mandate law had been in force from the time of the first Commercial Ordinance enacted in Malta, which included the word *mandato* in its Italian text. This Ordinance was influenced by the French Commercial Code 1807, which also makes reference to the applicability of the law of mandate under Article 18.<sup>339</sup>

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<sup>339</sup> Vide Article 18

A clearer reference to the law of mandate in the Maltese Commercial Codes was introduced with the enactment of Article 3 of Act XXX 1927,<sup>340</sup> which stated that the fiduciary duty of directors shall be regulated by the Code itself, by any commercial laws or mercantile customs in the absence of the Code, and in the absence of these laws or customs, by the Civil Code 1870. During this time, however, neither the Commercial Code itself nor the commercial laws or mercantile customs regulated the fiduciary duty of directors, but by the time this Act was enacted, the Maltese Civil Code 1870 that lays down the mandate provisions had also been enacted. Consequently, the law of mandate as enacted under the Maltese Civil Code 1870 began to be applied. Although Article 3 makes reference to civil law, only the law of mandate could be applied in this particular instance, as the law of mandate was the only body of laws enacted under the Maltese Civil Code 1870 that could regulate relationships in which one person commands another to carry out an act on their behalf. In fact, a mandate has always been defined by Maltese statute law (today, under Article 1856 of the Maltese Civil Code 1870) as a contract in which a person gives the power to do something for them to another. This provision was originally influenced by Article 1737 of the Italian Civil Code 1865,<sup>341</sup> which in turn was influenced by Article 1984 of the French Civil Code.<sup>342</sup> These provisions also shed light on the interpretation of the fiduciary duty, which in general terms shows the importance of directors as mandataries acting honestly and in the best interests of the company when applied to the corporate field of law, even though the statute law does not make any explicit reference to the relationship of trust created between these two persons.

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<sup>340</sup> Vide Article 3

<sup>341</sup> Italian Civil Code 1865, <<http://www.notaio-busani.it/it-IT/codice-civile-1865.aspx>> accessed 5 December 2014. The same definition is retained in the Italian Civil Code 1942 under Article 1703 <<http://www.rcscuola.it/disciplina/ccivile.pdf>> accessed 5 December 2014

<sup>342</sup> Vide Article 1984

The same approach continued to apply with the enactment of the Commercial Code 1942, which also included Article 3 of which lays down that in the absence of commercial law and custom usages, the fiduciary duty of directors shall be governed by the Maltese Civil Code 1870. Since commercial law and custom usages were absent in their regulation of the fiduciary duty of directors, recourse to the Maltese Civil Code 1870 – specifically, to the law of mandate – had to be carried out once more. This particular Commercial Code also enhanced the reference to the law of mandate through the explicit introduction of the word ‘mandate’ in the English version in Article 156.<sup>343</sup>

Ancillary reference to the law of mandate when regulating the fiduciary duty of directors continued to be resorted to with the enactment of the Commercial Partnerships Ordinance 1962, which again included Article 3. Article 3 states that: ‘Commercial partnerships shall be governed by this Act:- Provided that where no provision is made in this Act, the usages of trade or, in the absence of such usages, the Civil Law shall apply’. Consequently, mandate law, as enacted under the Maltese Civil Code 1870, continued to govern the regulation of the fiduciary duty of directors. However, with the enactment of this Ordinance, certain English influences were also included that regulate the interpretation and application of the fiduciary duty of directors. In these particular instances, the English legal system was to be referred to so as to facilitate interpretation of these particular provisions, and the law of mandate could not be resorted to in these particular regulated instances. Hence, this Ordinance introduced a situation in which the general fiduciary duty of directors was to remain regulated by the law of mandate; however, if a particular provision influenced by the English legal system was enacted in the Ordinance, such as the duty not to let personal interests conflict with those of the company, the

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<sup>343</sup> Vide Article 156 (1)

fiduciary duty in that particular circumstance would be read and construed only in light of the English legal system, and not in light of the mandate law.

The fact that the Italian civil legal system and the English legal system were being applied concurrently under the Maltese legal system might have been the reason for the abrogation of Article 3 of the Ordinance by the enactment of the Companies Act 1995, which superseded the 1962 Ordinance. This resulted in a situation in which any explicit reference to the mandate law was totally removed.<sup>344</sup> Hence, from 1995, any law could theoretically be applied to the regulation of the fiduciary duty of directors; however, the law of mandate, intertwined as it was with the English legal system, continued to apply until the enactment of Article 136 A in the Maltese Companies Act 1995 since as explained above, only the law of mandate, as interpreted through the English legal system should there be a loophole, could apply for the relationship between two persons wherein one person is acting for another person, which, therefore, could only apply to regulate the relationship between a director and the company.

This fiduciary duty is composed of various sub duties. The separate limbs of the duty will now be reviewed by referring to the Maltese mandate provisions, to any Maltese *res judicata* judgments and to the Italian and English legal systems to better understand these sub duties as interpreted under the Maltese legal system.

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<sup>344</sup> Companies Act 1995, <<http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lp&itemid=22668&l=1>> accessed 5 December 2014

#### **4.3.1 Duty to act in good faith and in the best interests of the company**

Any mention of fiduciary duty inevitably brings to mind the good faith principle. A director is under an automatic duty to act in good faith and in the best of interests of the company, or he would be exposed to an allegation of fraud by the company, which was acting as the mandator.<sup>345</sup>

However, this good faith principle was not explicitly laid down in any Maltese commercial Ordinance or Act that was passed to regulate commercial relationships until 2003; nor does it arise under the French, Italian or Maltese Civil Codes under the law of mandate. Mandate law under Article 1873 of the Maltese Civil Code 1870 only entails that a mandatary is bound to carry out the mandate with which they are vested, and does not specify whether a director is required to act in good faith when carrying out this mandate.

It is also important to understand whether or not this good faith principle shall be applied by directors within the strict interpretation applied to the term ‘company’. That the director is the mandatary is never contested under Maltese law, but discrepancies arise with respect to the interpretation of the company as the mandator that enjoys a legal personality in its own right, which may be subjected to the interpretations imposed on it and to the understanding of the separate legal personality principle. Mandate law, as enacted under the Maltese Civil Code 1870, does not clarify the identity of the mandator, since mandate law applies to any situation in which one person is acting on behalf of another. However, this can be resolved through an examination of the Maltese commercial ordinances and acts enacted throughout the years. The

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<sup>345</sup> Ferrarotti Teonesto, *Commentario Teorico Pratico comparato al Codice Civile Italiano*, (1<sup>st</sup> edn, Kessinger Publishing Co 2010)

first Maltese Ordinance, Ordinance XIII of 1857, enacted Article 69 with respect to limited liability companies or, as they were then known, anonymous partnerships. The Article states that:

‘Previously to the making of any such enrolment, exhibition, or publication, the parties acting as managers of an anonymous partnership shall be liable, both personally and in solidum, for their operations to third parties’.

Therefore, this provision presents the concept of the company being considered as the mandator that enjoys its own legal personality, such that the directors could no longer be held personally liable for any acts done on behalf of the company after its formation; rather, the company itself should be liable. This notion of the company being considered the mandator with separate legal personality is further enhanced through Article 63 of this Ordinance 1857.<sup>346</sup> This approach seems to be most suitable because the French Commercial Code 1807, which influenced this Maltese Ordinance, explicitly states that an anonymous partnership is formed for a particular purpose and personal liability on the shareholders is avoided.<sup>347</sup> Consequently, this French Commercial Code 1807 emphasises the separate legal personality enjoyed by the company, which in turn shows that the company is to be considered the legal mandator. During this period, a different approach was nonetheless taken by the Maltese Courts in *Francesco Saverio Musu’ v Vincenzo Di Saverio Vella*,<sup>348</sup> in which it was established that the directors were to be considered as the mandataries of all the shareholders as a collective body, rather than of the company. This judgment did not make any reference to the company as the mandator through

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<sup>346</sup> Vide Article 63. The word ‘partnership’ in this Code refers to companies because this article was enacted with respect to the *societe anonime*, which were later re-defined as limited liability companies.

<sup>347</sup> Articles 29 and 30 of the French Commercial Code <<http://gallica.bnf.fr/ark:/12148/bpt6k56629t/f5.image>> accessed 5 December 2014

<sup>348</sup> 11/11/1890 (Commercial Court)

the application of the separate legal personality principle, but instead considered the shareholders as the legitimate mandators.

Act XXX 1927 and the 1942 Act<sup>349</sup> did not contest the statutory approach presented above with respect to the interpretation of the mandator with separate legal personality, and the same reasoning accordingly continued to apply. However, by the time these two acts were passed in Malta, the Italian Commercial Code 1865,<sup>350</sup> as superseded by the Italian Commercial Code 1882,<sup>351</sup> had been enacted, and that these Codes influenced the Maltese approach. They were themselves influenced by the French Commercial Code. Accordingly, the first Maltese Commercial Code and these two other Maltese Commercial Codes were ultimately based on the same reasoning. Both Italian Codes made specific reference to the separate legal personality enjoyed by the company, thus suggesting that the company is interpreted to be the mandator, as in the French approach. Nevertheless, the Maltese Courts again challenged the statutory approach in *Giovanni Anastasi noe v Kaptan Serafino Xuereb M.B.Eet.*<sup>352</sup> Here, although the Courts declared that the directors should be considered as mandataries of the company, it also held that the directors are mandataries of all the shareholders as one body. Therefore, when the Court made reference to the word ‘company’ at the beginning of its judgment, it was in reality (and erroneously) referring to the shareholders, not the company.

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<sup>349</sup> Vide Article 153. The separate legal personality notion is also reinforced with the enactment of article 162

<sup>350</sup> Vide Article 130 of the Act <<http://www.antropologiagiuridica.it/codecomit65.pdf>> accessed 5 December 2014

<sup>351</sup> Vide Article 122 <<http://www.antropologiagiuridica.it/codecomit82.pdf>> accessed 5 December 2014.

<sup>352</sup> 14/06/1951 (Third Part)

The statutory reasoning that the company is the legitimate mandator because it enjoys a separate legal personality from its shareholders and directors was again not challenged in the Commercial Partnerships Ordinance 1962,<sup>353</sup> and was even clearly codified in the Ordinance itself for the first time. The 1954 Maltese Commission's report, which led to the drafting of this Ordinance, considered that 'the draft embodies the essential characteristic of commercial partnership, namely that it is a "persona" distinct and separate from its members, created by operation of law and arising out of a contract'.<sup>354</sup> The notion of separate legal personality was consequently unequivocally reflected in and inserted under Article 3 (2) of the Act, which states that 'A commercial partnership has a legal personality distinct from its members'. This Ordinance was, however, influenced by English developments, specifically by Section 1 of the United Kingdom's Companies Act 1948,<sup>355</sup> and not by the Italian legal system. Accordingly, with the enactment of this Maltese Ordinance 1962, mandate law was being applied in accordance with the English influence, yet the same principle of the company enjoying a separate legal personality continued to be reinforced. The Maltese Courts also seemed to reinforce the principle of the separate legal personality by also opting to apply the mandate law as influenced by the English system as stated in *John Veglio v Catherine Camilleri*,<sup>356</sup> who have departed from the previous approach taken by other Maltese judges and magistrates. The Court of Appeal, in fact, stated that a director has to act in the best interest of the company and a director shall only be considered as the mandatary of the company, without referring to the shareholders or other stakeholders. The same reasoning was again reached by the Maltese

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<sup>353</sup> Vide Article 121 (1).

<sup>354</sup> Number 6 of Commission report

<sup>355</sup> Companies Act 1948 <[http://www.legislation.gov.uk/ukpga/1948/38/pdfs/ukpga\\_19480038\\_en.pdf](http://www.legislation.gov.uk/ukpga/1948/38/pdfs/ukpga_19480038_en.pdf)> accessed 5 December 2014

<sup>356</sup> 22/01/1973 (Court of Appeal)

Courts in *Advocate Doctor Ian Refalo noe et v Albert David Boveck et*,<sup>357</sup> which also made reference to this previous judgment.

The notion that the company shall be considered as the mandator which enjoys a separate legal personality from its shareholders and directors<sup>358</sup> persisted even with the enactment of the Maltese Companies Act 1995 which was once again influenced by the English legal system, specifically by the 1985 Act.<sup>359</sup> Consequently, mandate law and the separate legal personality of the company were again applied as solely influenced by the English legal system. This strict interpretation applied to the term ‘company’ was discussed in the Maltese judgment *Video-On-Line Limited v Ian Giles*,<sup>360</sup> whereby the Court of Appeal reached the conclusion that a director shall act solely in the best interest of the company, which enjoys a separate legal personality from its shareholder or any other stakeholder. The Court of Appeal even pointed out that this principle shall not be contested in any manner.

Nevertheless, although one might believe the separate legal personality to be a very theoretical important principle, as also supported by statute law, to shield directors and shareholders from any acts of third parties, this principle does not apply in its true sense because shareholders have always enjoyed the right to change directors. Therefore, indirectly, shareholders would seem to control the directors, as they enjoy full power to choose the directors of the company, particularly when the shareholder and the director are the same person. As a general notion,

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<sup>357</sup> 18/03/1983 (First Hall Civil Court)

<sup>358</sup> Vide Article 4(4)

<sup>359</sup> Vide Section 1

<sup>360</sup> 25/02/2004 (Court of Appeal) Cit. Nru. 339/2002/1

therefore, shareholders also control the acts of the company, as directors may well decide to act in the interests of the shareholders to ensure that they are re-elected.

#### **4.3.2 Duty to promote the wellbeing of the company and responsibility for its general governance and supervision**

At first glance, this aspect of fiduciary duty does not seem to arise from the Commercial Ordinances and Acts enacted in Malta until 2003. The reason for this is that from the very first enacted Ordinance of 1857, it was asserted that ‘the managing partners are under no other obligation than that of fulfilling the charge received’.<sup>361</sup> The directors’ duty consequently seemed to be limited to what was expressly laid down in the mandate contract, such that directors could not carry out any other act that would promote the wellbeing of the company or reflect a general supervisory attitude. This approach was copied from the French Commercial Code of 1807, which influenced the Maltese Ordinance in question; Article 32 of this Ordinance states that the directors are only responsible for the execution of the mandate with which they are trusted. To further support this notion, Article 1987 of the French Civil Code stipulates that a given mandate may be special, and is therefore only given for a specific purpose. Nevertheless, when one delves further into the mandate provisions, it can be seen that this duty to promote the wellbeing of the company and to be responsible for its general governance and supervision is indirectly included under the mandate provisions. The same Article 1987 of the French Civil Code 1804 also entails that a mandate can be given for a general purpose, and that in such a case, the mandatary is responsible for the general governance of the mandate and can carry out any ordinary act so as to be in a position to execute

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<sup>361</sup> Vide Article 63

the mandate in the best manner possible. This is further specified by Article 1988 of the French Civil Code 1804.<sup>362</sup>

This generic position presented by the 1857 Ordinance was not challenged with the enactment of the 1927 Act or in the 1942 Act.<sup>363</sup> However, these two provisions were influenced by the Italian Commercial Codes 1865<sup>364</sup> and 1882,<sup>365</sup> even though these Codes were also based on the French Commercial Code 1807. One minor difference between these mandate provisions as enacted under the French and Italian legal system emerges in that the Italian provisions go a little further by also providing that a mandatary is required to act within those limits imposed by law; thus implying that the mandatary can only carry out those ordinary acts defined by law. The same reasoning as applied above continues to apply, as reinforced with the coming into force of the Maltese Civil Code 1870; this Code also provides that the mandate can be a general one in which the mandatary can carry out any ordinary act of administration to carry out the mandate in the best possible manner,<sup>366</sup> as influenced by Article 1741 of the Italian Civil Code 1865.<sup>367</sup> This part of the fiduciary duty was embodied by the Maltese mandate provisions, as the Maltese Civil Code 1870 under Article 1865<sup>368</sup> provided that the mandatary may, among other actions, institute proceedings and enforce judgments in the name of the company. The Maltese law of mandate also imposed a limitation on the mandatary, who could not sue or be sued when the mandator is in Malta. This provision therefore indicates that the company shall always be sued or sue in its own name, as it will always be in the Maltese territories. This latter

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<sup>362</sup> Vide Article 1988

<sup>363</sup> Vide Article 156(1)

<sup>364</sup> Vide Article 122

<sup>365</sup> Vide Article 130

<sup>366</sup> Vide Articles 1862 and 1863 of the Maltese Civil Code

<sup>367</sup> Vide Article 1741

<sup>368</sup> Vide Article 1865

leniency was however not influenced by the 1865 and 1942 Italian Civil Codes, which did not provide for such tolerance.

This Maltese approach described above changed substantially with the enactment of the 1964 Ordinance<sup>369</sup> and the 1995 Act,<sup>370</sup> which stipulated that the broad discretion enjoyed by the directors shall only be exercised within the limitations imposed by law or by the Ordinance or Act itself. These two Commercial Codes provided that the directors may carry out any act except those prohibited by law or by the memorandum and articles of association of the company. It provided that certain acts shall be exercised by the general meeting only, and the memorandum and articles of association of the company provided for an objects clause that restricted the directors' actions. Consequently, this part of the fiduciary duty seems to have been limited for the first time under the Commercial Codes. The broad discretion imposed by the mandate provisions thus did not automatically continue to apply under these two Maltese Commercial Codes. Such a restricted approach goes beyond the Italian Commercial Codes, as the Maltese system also included the restrictions that may be imposed by the memorandum and articles of association of the company, even if the law might otherwise have allowed such an act to be carried out by the directors. At the same time, the 1948<sup>371</sup> and 1985<sup>372</sup> English commercial acts also provided for restrictions on the actions of directors by enlisting an objects clause in the memorandum and articles of association. In this way, it is clear that the Italian and English interpretations were fully endorsed in the Maltese legal system.

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<sup>369</sup> Vide Article 121 (1)

<sup>370</sup> Vide Article 137 (2)

<sup>371</sup> Vide Article 2 (1) (a)

<sup>372</sup> Vide Article 2 (1) (c)

After establishing the definition of this duty, it is important to understand to whom this duty is owed. As discussed above, the separate legal personality of the company is key under the Maltese company law principles, but can only be applied within the stringent interpretation presented above.

#### **4.3.3 Duty not to make secret or personal profit without the consent of the company, nor make personal gain from confidential company information**

At first glance, this part of the fiduciary duty appears to pertain to one principle; in reality, however, it seems to be split into two under the law of mandate, namely into secret gains and personal gains. Although neither of these gains is explicitly listed in any commercial ordinance or act enacted in Malta until 2003, a distinction between these two seems to have arisen under the mandate provisions that regulated the fiduciary duty of directors. Mandate law seems to require that secret profits are exclusively prohibited, because the mandatary is bound to enlist any profits or gains made to the mandator; at the same time, however, a personal gain or profit is not prohibited, as long as the mandatary provides a detailed account of their acts and was still acting within the limits of the mandate when he procured such personal profits or gains. The reason for this approach is because Article 1993 of the French Civil Code 1804 and Article 1747 of the Italian Code of 1865 provide that every mandatary shall render an account to the mandator and list all that he has received, even if he has received something during the course of the execution of the mandate that was not due to the mandator. This approach influenced the Maltese legal system, such that Article 1875 of the Maltese Civil Code 1870 provides that the mandatary, unless expressly exempted by the mandator, is bound to render an account to the mandator of the management of everything received by virtue of the mandate, even if what was

received was not due to the mandator. Nevertheless, some legal scholars<sup>373</sup> contest the personal gain notion, contending that even if this profit or gain was accounted for, the mandatary would still be prohibited from making these profits or gains, because if the mandatary were to obtain such benefits, they would be breaching the trust relationship that they enjoy with the mandator, since the mandatary would also be using their powers for their own benefit.

This interpretation of this duty seems to have been clarified with the enactment of the Maltese Commercial Partnerships Ordinance 1962, wherein an indirect limitation of this duty regarding the gain of personal profits was introduced; this provision was retained in the Maltese Companies Act 1995. Article 127<sup>374</sup> of the Ordinance and Article 144<sup>375</sup> of the 1995 Act prohibit loans to directors. A loan may lead to a personal profit for a particular director and at the same time also mean a debt for the company. These two specific provisions were not influenced by the Italian legal system, but were instead influenced by the 1948 and 1985 United Kingdom's Acts; sections 190 and 330 of which also envisage this prohibition, respectively. This prohibition was specifically included under the English legal system because, in 1945, the Cohen Committee considered that it:

‘is undesirable that directors should borrow from their companies. If the director can offer good security, it is no hardship for him to borrow from other sources. If he cannot offer good security, it is undesirable that he should obtain from the company credit which he would not be able to obtain elsewhere’.<sup>376</sup>

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<sup>373</sup> M.C. Kuchhak and Vivek Kuchhal, *Business Legislation for Management*, (4<sup>th</sup> edn., Vikas Publishing House Pvt Limited 2014) 482

<sup>374</sup> Vide Article 127

<sup>375</sup> Vide Article 144

<sup>376</sup> Report of the Committee on Company Law Amendment, Cmnd. 6659, 1945, para. 94

This prohibition was also extensively discussed in *Champagne Perrier-Jouet SA v HH Finch Ltd*,<sup>377</sup> which concerned the indebtedness of James Lynch, a director of the defendant company. The Court defined a loan as a sum of money lent for a period of time, to be returned in money or money's worth, and decided that a director is prohibited from making any gain or personal profit, whatever the circumstances. Nevertheless, there might be instances in which this provision cannot be fully enforced if the argument made by the director is that the payment made was not a loan but remuneration. This specific problem was discussed in depth in *Currencies Direct Ltd v Ellis*<sup>378</sup> where the defendant, who was a shareholder and director of the claimant company, received sums in cash and other forms of payment for expenses he had incurred. The claimant company sought repayment of around £250,000 after the defendant was excluded from the company. However, Ellis argued that he had received the money as remuneration. The judge accepted the defendant's argument and only awarded the claimant company around £45,000, which were acknowledged to have been given to the director as a loan and not as remuneration.

Another important notion is that this duty seems to be directly addressed to the company, but the principle of the separate legal personality of the company can only be applied within certain limitations as discussed above. Consequently, as a concluding remark, it is noted that this duty shall be observed by directors for the benefit of shareholders and any other stakeholder.

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<sup>377</sup> [1982] 1 W.L.R. 1359

<sup>378</sup> [2002] 1 B.C.L.C. 193

#### **4.3.4 Duty not to let personal interests conflict with the interests of the company**

Fiduciary duty also entails that a director of a company must avoid situations in which they have a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This duty had never been expressly included in the Maltese legal system until the English influences began to make themselves felt because the law of mandate entails only that the mandatary is required to execute the mandate; therefore, a mandatary may have a personal interest that conflicts with that of the mandator, but cannot be held in breach of this duty provided that they act within the parameters of the mandate. However, at the same time, it might also be argued that this duty might seem to have been indirectly provided for from the first Maltese Commercial Ordinance under the law of mandate because it requires that the director, as mandatary, shall act in good faith and in the best interests of the company; and the mandatary could not be said to be acting in good faith if their personal interests were in conflict with the interests of the company.

This conflict was resolved with the enactment of Article 128 (1)<sup>379</sup> Commercial Partnerships Ordinance 1962, which codified this duty. This same duty is retained in the Maltese Companies Act 1995 under Article 145.<sup>380</sup> Thus, from 1962 onwards, the mandatary was required to ensure that they were never in a position to let their personal interests conflict with those of the company. This new provision also introduced a new concept in that this provision necessarily superseded the law of mandate. As these two statutory provisions were influenced by Section 199<sup>381</sup> of the 1948 Act and Section 317 (1)<sup>382</sup> of the 1985 United Kingdom's Acts and not by

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<sup>379</sup> Vide Article 128 (1)

<sup>380</sup> Vide Article 145

<sup>381</sup> Vide Section 199

<sup>382</sup> Vide Section 317 (1)

the Italian legal system, the English legal system can be seen to have displaced the Italian system. The English common law principle of the no-conflict rule, accordingly, also began to be applied. It has been applied strictly under English law since the nineteenth century, as can be observed from the judgment in *Aberdeen Rly Co v Blaikie Bros*.<sup>383</sup> Blaikie Bros held a contract with Aberdeen Railway to make iron chairs at a specified price. Aberdeen Railway alleged a conflict of interest, arguing that they were not bound by the contract because, at the time of signing, the chairman of its board of directors, Sir Thomas Blaikie, was also the managing director of Blaikie Bros. Lord Cranworth LC upheld Aberdeen's argument with the result that the claimant was thus deemed not to be bound by the contract. His Lordship held that:

‘no one, having [a fiduciary duty] to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect’.<sup>384</sup>

The same approach was again taken in the English case of *J J Harrison (Properties) Ltd v Harrison*.<sup>385</sup> The defendant acquired property from the claimant company while holding the position of director of the claimant company. The defendant failed to inform the company of key information that could substantially affect the property's value, such as that this property already had a building permit. The Court found the defendant liable for breach of his fiduciary duty.

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<sup>383</sup> [1854] UKHL 1

<sup>384</sup> Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia* (2<sup>nd</sup> edn, The Federation Press 2002) 345

<sup>385</sup> [2002] 1 BCLC 162

The English judgments go a step further, as they hold that this duty shall be continuously and rigorously observed even upon the resignation of the director. Although this specific prohibition is not catered for under the Maltese law, the same approach would surely be applied by the Maltese Courts, since the Maltese statutory provisions were entirely influenced by the English legal system. The very rigid interpretation of this duty was applied in *Island Export Finance Ltd v Umunna*<sup>386</sup> in which the claimant company had a contract with the Cameroon government to supply it with post boxes. Umunna, managing director of the claimant company, worked on the contract but resigned from his position of director following completion and subsequently entered into a similar contract in his own name. Island Export claimed damages due to this second contract. The Court held that Umunna was required to observe his fiduciary duty even after his resignation, and was therefore in breach of this part of the fiduciary duty.

This duty also comes into play when, for instance, a director holds a directorship in two or more competing companies. Although the Maltese Courts have never had the opportunity to voice their opinion on this specific issue, reference to English judgments can assist in its interpretation. Initially, the English Courts did not strictly interpret this duty, with the consequence that such a circumstance was not considered to give rise to a conflict of interest on part of the directors, as interpreted in *London and Mashonaland Exploration Co v New Mashonaland Exploration Co*,<sup>387</sup> Lord Mayo was a director and chairman of the claimant company who had never expressly or tacitly agreed not to become a director of a competing company. Four months later, another company with the same purpose as the claimant company was formed and Lord Mayo also sat on its board of directors. Chitty J dismissed the claimant's

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<sup>386</sup> [1986] BCC 460

<sup>387</sup> [1891] WN 165

application, deciding that no conflict of interest had arisen. However, given the way the statutory provisions are drafted, if this same situation were to arise today, the person in question would surely be held in breach of this part of the fiduciary duty.

The duty to avoid conflicts of interest also applies in those instances in which a director is appointed as the nominee of a particular shareholder. While this has also never been considered under the Maltese legal system, reference to the English approach may once again shed some light. In *Scottish Cooperative Wholesale Society Limited v Meyer*,<sup>388</sup> it was held that a director must always ensure that his duty to avoid conflict of interest is never breached, whatever the situation. In this case, the claimant wanted to set up a new company, Scottish Textile & Manufacturing Co Ltd., to manufacture rayon. At the time, a license was only granted if experienced managers were part of the company. The claimant company held the majority of shares, and another three members, who were also directors of the claimant company, were appointed to the board of directors of the new company. The new company did not flourish, and the claimant company, as the major shareholder, decided to transfer this new business to a new subsidiary company. In this respect, Lord Denning stated that the nominee directors ‘probably thought that ‘as nominees’ of the [majority shareholder] their first duty was to the [majority shareholder]. In this they were wrong’.

The no-conflict rule, as interpreted under English common law and as codified in the 1962 Maltese Commercial Ordinance and the 1995 Maltese Companies Act, shall also apply when there is an apparent conflict of interest; therefore, the duty shall not only apply in the event of

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<sup>388</sup> [1959] AC 324

an outright conflict of interest between the directors and the company, but the director is also obliged to consider whether their outside interests are likely to give others the impression that there may be a conflict. Again, reference to English judgments sheds light on the interpretation and application of this duty in this regard. In the English case *Boardman v Phipps*<sup>389</sup> it was held that the term ‘possibly may conflict’ means ‘that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict’.<sup>390</sup>

The significance of this duty is also expressed in the English common law approach to the no-profit principle. This duty was clearly expressed in *Bray v Ford*.<sup>391</sup> Bray was a governor of Yorkshire College, while Ford was the vice-chairman of the governors and the solicitor of the college. Bray sent Ford a letter, which was also circulated to others, alleging that Ford had breached his fiduciary position as vice-chairman of the college by making a profit as its paid solicitor. In this respect, Lord Herschell stated that:

‘it is an inflexible rule of a court of Equity that a person in a fiduciary position, such as the respondent’s, is not, unless otherwise expressly provided, entitled to make a profit, he is not allowed to put himself in a position where his interest and duty conflict’.<sup>392</sup>

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<sup>389</sup>[1967] 2 AC 46. While this judgment is a landmark example of English trusts law and does not deal with corporate law, its reasoning can be equally applied to the fiduciary duty of directors

<sup>390</sup> Ashley Black, ‘Equitable and statutory regulation of conflicts of interests and duty’, Presentation at University of New South Wales Law School 10 May 2016 <[http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2016%20Speeches/Black\\_20160510.pdf](http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Speeches/2016%20Speeches/Black_20160510.pdf)> accessed 10 July 2018

<sup>391</sup> [1896] AC 44

<sup>392</sup> A.J. McClean, ‘The Theoretical Basis of the Trustee’s Duty of Loyalty’, 218 Alberta Law Review <<https://www.albertalawreview.com/index.php/ALR/article/download/1912/1901>> accessed 20 August 2018

Due to this prohibition, it means that it is immaterial whether the company could take advantage of the property, information or opportunity that has been diverted away from it by its directors. Although the mandate provisions do not stipulate the occurrence of such an event as a breach of duty, the English influences would lead to an inclusion of this prohibition by the Maltese Courts as will be demonstrated hereunder. A leading English judgment that has rigorously applied this principle is *Regal (Hastings) Ltd v Gulliver*.<sup>393</sup> This case concerned a company, Regal, which owned a cinema in Hastings. Its directors wished to acquire two other local cinemas to facilitate the sale of the whole undertaking as a going concern. Consequently, these directors decided to form a subsidiary company to lease the other two cinemas, but the landlord was not willing to grant the subsidiary company a lease unless the directors agreed to take a personal guarantee or the paid-up capital of the subsidiary company was £5,000. However, it was not possible to raise more than £2,000 and the directors objected to the personal guarantee. Accordingly, the original scheme had to be altered. It was later decided that Regal would subscribe for 2,000 shares and that the outstanding 3,000 shares would be taken up by the directors and their associates. Later on, the whole undertaking was sold by way of takeover and the directors made a huge profit. The new owners of Regal appointed a new board of directors and the company brought an action against the former directors, claiming that they were required to account for the profit they had made on the sale of their shares in the subsidiary company. The House of Lords found in favour of Regal. The same approach was reached by the Maltese Courts in *Victor Grima noe v Anthony Grech*.<sup>394</sup> Grech, the director of a company, enticed its customers to end their relationship with the company and enter into a new relationship with him. The Court held that Grech's behaviour went against his duty, and he was therefore in breach.

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<sup>393</sup> [1942] UKHL 1

<sup>394</sup> 09/12/1968 (Court of Appeal)

Once more, this duty seems to be addressed to the company; however, the principle of separate legal personality of the company shall only be applied within its own limitations, as analysed above. While it is true that these judgments make reference only to the company, the fiduciary duty of directors shall also be observed in light of the developments that have taken place in recent years (vide Chapter 2) and shall, therefore, be applied by directors in favour of the shareholders as a body and of other stakeholders.

**4.3.5 Duty not to use any property, information or opportunity of the company for personal or anyone else's benefit or obtain any benefit from their power, except with the consent of the company at the general meeting or as permitted by the memorandum and articles of the company**

This part of the fiduciary duty is important, as it provides for an alternative approach to the other parts of the fiduciary duty detailed above. This is because the other parts may not be considered to be in breach if the actions in question were approved by the shareholders or provided for in the memorandum and articles of association of the company.

From the very beginning, the law of mandate as arising out of the Maltese Civil Code 1870 has dictated only that directors, as mandataries, were under an obligation to act within the limits of the mandate. Accordingly, the directors should ask for permission from the company before using any property, information or opportunity for their own benefit if such permission was not expressly included in the mandate. This general approach was influenced by the French and Italian legal system. Nevertheless, should a director act in breach of his fiduciary duty, this

breach can be excused by the shareholders or if the memorandum and articles of association of the company permits such behaviour. This tolerance was, however, only codified in the 1962 Maltese Ordinance with the enactment of Article 126 (1)<sup>395</sup>. This duty was again retained under Article 143 (1) of the 1995 Act. However, it is observed that these provisions were influenced by neither the Italian nor the English legal systems, and the Maltese legal system opted to apply tolerances to the no-conflict and no-profit principles since it possibly deemed this to be appropriate in the best interest of the company, especially for third parties that would have entered into negotiations with the company. However, one problem that may arise under the application of this duty is that the way such leniency was drafted seems not to apply the fundamental principle of the company having a legal personality that is separate from its shareholders, directors or any other stakeholder. This is because the company's interests are not taken into consideration; rather, the shareholders can approve any of the director's actions during a general meeting or to approve any changes that are deemed appropriate to the memorandum and articles of association of the company. Another issue is that if a director is a shareholder, the Maltese provisions do not exclude them from voting at that particular general meeting; this means that if a director is also the major shareholder or enjoys sympathy from the majority of shareholders, then the resolution will pass, which may be detrimental to the company. This approach might be interpreted that the influences exerted by the ESV principle (vide Chapter 2), and their incorporation into Maltese law long before the English legal system had begun to apply it, but this approach may be challenged under the Maltese system due to the fact that it had never been explicitly clarified. In fact, the interpretation of this duty was never challenged before the Maltese Courts, whose interpretations would have helped to resolve this matter.

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<sup>395</sup> Vide Article 126(1)

As already noted, the English legal system does not provide for such leniency. However, the English Courts have discussed the possibility of such leniency arising. In fact, it may be stated that the Maltese legal approach was loosely applied by the English Courts in the English case *Parker v McKeena*.<sup>396</sup> Although the importance of the general meeting to approve any act of the director was not directly referred to and reference to the company as a separate legal personality seems to have been made, albeit without interpretation of the extent to which this should be understood, it was demonstrated that any director shall only act if the principal also agrees, thus implying that in actual fact the directors were subjected to the shareholders' approval either through a general meeting or if approved through the memorandum and articles of association of the company. McKeena was one of four directors of a joint stock bank, the National Bank of Ireland. In 1864, resolutions were passed to increase capital by issuing 20,000 shares at £50 per share, which were to be offered first to existing shareholders in proportion to how many shares they already held. Any shares that were not bought would be thereafter sold by the directors at a £30 premium. Stock initially took almost 10,000 shares, but later declared that he could not take them all and asked the directors to relieve him. The directors took the shares and resold them at a profit. However, the Court concluded that an agent cannot make any profit without the consent of his principal and therefore decided against the directors.

Some years later, the English Courts were once again faced with this dilemma in *Industrial Development Consultants Ltd v Cooley*,<sup>397</sup> in which the same approach demonstrated above was again adhered to. Cooley was an architect employed as managing director of the claimant company, which formed part of IDC Group Ltd. The Eastern Gas Board had a lucrative project

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<sup>396</sup> (1874) 10 Ch. App. 96

<sup>397</sup> [1972] 1 WLR 443

pending to design a depot in Letchworth, and informed Cooley that it wanted to contract with him personally rather than with the claimant company. Consequently, Cooley informed the claimant's board of directors that he was feeling unwell, resigned, and later undertook the design work on his own account. Nevertheless, Roskill J held him liable for the benefits he received and for breach of the duty to avoid conflict of interest without informing his principal. Notably, it was held that, although IDC Group Ltd did not stand a chance of getting the contract, Cooley still had a strict duty to protect the interests of the company and ought not to have allowed his interests to conflict with those of the company, unless the company had given consent. Quoting *Parker v McKenna*,<sup>398</sup> Roskill J held that:

‘no agent in course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge and consent of his principal; that the rule is an inflexible rule, and must be applied inexorably by this court, which is not entitled, in my judgment, to receive evidence, or suggestion, or argument as to whether the principal did not did not suffer any injury’.<sup>399</sup>

#### **4.3.6 Duty to exercise the powers they were given and not to misuse those powers**

This part of the fiduciary duty stipulates that the directors must act within the limits of the mandate, cannot exceed the powers conferred upon them and to also use these powers in light of the other parts of the fiduciary duty such that if for instance a director has the power to negotiate for and on behalf of the company, they must disclose any interest if there is any. From the very beginning, this duty was given great importance. Article 63 of Ordinance XIII of 1857<sup>400</sup> clearly points out that the directors shall only carry out those acts entrusted to them, and that the company shall, in its deed of formation or in any other agreement between the

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<sup>398</sup> (1874) 10 Ch. App. 96.

<sup>399</sup> David Kershaw, *Company law in context: text and materials* (2<sup>nd</sup> edn, Oxford University Press 2012) 543

<sup>400</sup> Vide Article 63

directors and the company, clearly point out those acts that can be carried out by the director. The 1927 Act and the 1942 Act did not challenge the approach taken under the Ordinance.

However, these Articles must be interpreted in light of the law of mandate, and to Articles 1987 of the French Civil Code, as it was used to regulate the first Ordinance in Malta. This Article states that a mandate can be either special, i.e. enlisting a certain particular act or specific acts only, or general, i.e. can include any act. In this regard, reference to Article 1988 shall also be made which although this Article limits the application of the general mandate by specifying that it can only be exercised in terms of the ordinary acts of administration, these acts may also lead to the mismanagement of the company, because (for example) the management of a bank account is categorised as an ordinary act.<sup>401</sup> Consequently, although it is true to say that acts of an extraordinary nature are still required to be explicitly included in any such agreement, acts of an ordinary nature are still considered to be of the utmost importance, although these are not regulated with the same rigour. These two provisions influenced the drafting of Articles 1740<sup>402</sup> and 1741<sup>403</sup> of the 1865 Italian Civil Code, which in turn influenced Articles 1862<sup>404</sup> and 1863<sup>405</sup> of the mandate provisions arising under the Maltese Civil Code 1870. Sir Adrian Dingli, in his notes on the Civil Code,<sup>406</sup> also observes that when a mandate is given in general terms, it shall only include ordinary acts of administration, while extraordinary acts of administration shall be excluded altogether unless expressly included in the memorandum and

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<sup>401</sup> Article 1322 of the Maltese Civil Code specifically enlists those acts that are categorised as acts of extraordinary nature, which are in general very much tied to immovable rather than movable property. The same article entails that any act not categorised as an extraordinary act shall be automatically classified as an ordinary act.

<sup>402</sup> Vide Article 1740

<sup>403</sup> Vide Article 1741

<sup>404</sup> Vide Article 1862

<sup>405</sup> Vide Article 1863

<sup>406</sup> Dingli (n 300) 29

articles of association of the company or in any other agreement that regulates the relationship between directors and the company.

The importance of the directors abiding by such a duty has been demonstrated by the Maltese Courts in various judgments. The first was *Francesco Saverio Musu' v Vincenzo Di Saverio Vella*.<sup>407</sup> Some years later, the Maltese Courts were again faced with the interpretation of this duty, particularly as it concerns the interpretation of a general mandate, in *Giovanni Anastasi noe v Kaptan Serafino Xuereb M.B.E et*,<sup>408</sup> in which the Court applied the definition of the general mandate as presented by the statutory provision of the Maltese Civil Code 1870. In fact, the Court held that a general mandate implies that directors can only carry out ordinary administrative acts, unless the memorandum and articles of association of the company indicate otherwise. Thus, in this case, the Courts held that the winding up and liquidation of the company was a decision that could only be made by the shareholders and is therefore classified as an extraordinary act, unless the memorandum and articles of association specifically allowed this decision to be made by the directors. The decision to liquidate was therefore declared null in this particular instance, since the directors had made it. Regrettably, the Courts could only express their view on the act in question and were not asked to provide an interpretation of those ordinary acts that could be carried out by the directors alone.

The importance of acting within the given mandate and to specify any additional duty that may be carried out by directors was maintained with the enactment of the 1962 Ordinance and the

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<sup>407</sup> 11/11/1890 (Commercial Court)

<sup>408</sup> 14/06/1951 (Third Part)

1995 Act. However, a new approach seems to have been taken in the 1962 Ordinance. Article 121 (1) of the 1962 Ordinance<sup>409</sup> and Article 137 (3) of the 1995 Act<sup>410</sup> provided for an approach in which, instead of enlisting each specific act that could be carried out by directors, the directors could carry out any act unless it was prohibited by law or by the memorandum and articles of association of the company. Nevertheless, this new liberal statutory approach does not seem to have been widely embraced by the Maltese Courts, which voiced their opinion as to the importance of specifically listing any permitted act that may be carried out by the directors. This approach was echoed in the Maltese case *Catherine, wife of Joseph Galea v Milica Micovic noe*.<sup>411</sup> The claimant alleged that there had been a promise of sale dated 25<sup>th</sup> February 1991, which had been extended by a note dated 31<sup>st</sup> March 1993. This promise of sale was an agreement between the defendant company and Albert Vella, in which the defendant company promised to sell and transfer the title of a property to Albert Vella, and he was then to transfer it to the claimant. The claimant therefore asked the Maltese Courts to oblige the defendant company to enter into a contract with the claimant herself, rather than through Albert Vella, so that this transfer of title could take place. The defendant company argued that the note of the promise of sale that had been entered into by Vella and the company had not been signed by both directors of the company, as required by the memorandum and articles of association, and that the promise of sale had thus not been legally extended, meaning that the parties were consequently no longer bound by the promise. At first instance, the Court accepted the defendant's argument, going so far as to state that, as he was the defendant company's auditor, Vella should have been aware that the promise of sale and any extension thereto must be signed by both directors. . Accordingly, the Court held that the promise of sale

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<sup>409</sup> Article 121 (1). With the enactment of this Ordinance, there was also the inclusion of a specific reference to the objects clause under article 15(d), whereby the powers that shall be exercised by directors are duly listed

<sup>410</sup> Vide Article 137(3). Reference to the objects clause is made under Article 14(d) of said Act

<sup>411</sup> 19/11/2001 (Court of Appeal) Cit. Nru 271/1993/1 GV

had not been validly extended by law as it was not signed by both directors. On appeal, the appellate Court restated that any act that could be carried out by the directors was required to be explicitly included in the memorandum and articles of association of the defendant company. To further emphasise the significance of this part of the fiduciary duty, the Court made reference to the Maltese judgment *Salvatore Schembri v Salvatore Gauci*,<sup>412</sup> which fully embraced this principle. Reference to *Palmer* was further made to substantiate the principle, who states that ‘the directors of a company are bound by the Articles. Their powers are to be derived from the articles and they must observe any restrictions imposed upon them by the latter’.<sup>413</sup>

This clarification leads to the rationale that, whenever a director acts outside the scope of those acts entrusted to them, or extends the limitations of such acts, they cannot impugn those acts to the company, and the director is consequently personally liable for those acts towards third parties. The 1857 Maltese Ordinance did not expressly provide for this personal liability, but it seems reasonable to conclude that, since directors are required to carry out only those acts within such limitations as are enlisted in their mandate, any act that goes beyond that mandate should be personally answered for by the directors. Nevertheless, there is also the principle that the company may decide to ratify this act to be bound by it; however, the Maltese Ordinance was silent on this ratification process. Reference to the law of mandate was thus necessary. Because the Maltese Civil Code 1870 was not yet enacted, reference to the French Civil Code 1804 was made, which outlines a ratification process under Article 1998. This process can take

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<sup>412</sup> 31/10/1983

<sup>413</sup> Ibid.

place either tacitly or expressly. This was embraced by the Maltese Courts, which clearly expressed their views about the significant ratification principle in *Coleiro v John Ellis*.<sup>414</sup>

The principle of personal liability of directors is also indirectly retained in the 1927 Act. However, the ratification principle that the company is required to carry out now arises under the Maltese Civil Code 1870 under the mandate provisions, specifically under Article 1880 (2),<sup>415</sup> as influenced by Article 1752<sup>416</sup> of the Italian Civil Code 1865, which in turn was influenced by the French Civil Code 1804. The ratification principle was once again adopted by the Maltese Courts in *John La Rosa noe v Carmelo Galea*.<sup>417</sup>

However, a drastic change was observed with the enactment of the 1942 Maltese Companies Act, as it introduced for the first time the personal liability of directors whenever they exceed their powers.<sup>418</sup> At the same time, the ratification principle continued to apply under the law of mandate, as provided by the Maltese Civil Code 1870 under Article 1880 (2)<sup>419</sup> and as influenced by the Italian legal system.

An express provision regulating the personal liability rule of the directors was, however, again abrogated with the enactment of the 1962 Ordinance, although the ratification principle was retained. However, as the 1954 Commission<sup>420</sup> pointed out, the English legal system was

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<sup>414</sup> 04/02/1914 (Court of Appeal) (Vol. XXI.i.93)

<sup>415</sup> Vide Article 1880 (2)

<sup>416</sup> Vide Article 1752

<sup>417</sup> 30/05/1958 (Court of Appeal) Vol. XLII.i.344

<sup>418</sup> Article 156 (2)

<sup>419</sup> Vide Article 1880 (2)

<sup>420</sup> Vide Chapter 3, in which this Commission was already discussed

referred to when the new company law statutory provisions were enacted, and that the English common law approach was therefore resorted to when considering the ratification principle rather than the Italian system. Nevertheless, it is noted that the ratification principles under the civil and common legal system are analogous and applied with the same rigidity; accordingly; both place the same degree of burden on directors. This ratification principle was discussed at length by the Maltese Courts in *Advocate Doctor Anthony H Farrugia as a special mandatary of the minors Fabienne Carbone and Rowan Carbone v Vernie Carbone for and on behalf of various companies and Agostino sive Winston Carbone, together with Advocate Dr. Eric Mamo, for and on behalf of other companies*.<sup>421</sup> The claimant alleged that any contract or agreement entered into and signed by one of the defendants, Agostino sive Watson Carbone, on behalf of various companies should be declared null and void, as the memorandum and articles of association of the company did not allow him to enter into such agreements, and the agreements were also never ratified by the company. The agreements in question all concerned loans and other banking facilities that had been given to various companies by Mid-Med Bank Limited, a bank today known as HSBC Bank Malta plc. While the First Hall Civil Court decided against the claimant, the Court of Appeal made reference to the Maltese judgment *Salvatore Schembri v Salvatore Gauci*<sup>422</sup> in which the Court had held that the directors of a company are bound by the company's memorandum and articles of association. It also made reference to statute law, finding that if an act does not fall within the remit of the director's powers, ratification should be carried out in accordance with Article 1880 (2) of the Maltese Civil Code 1870 in which as in this particular case, tacit acceptance may arise. Hence, although the English influences had begun to make themselves felt, the Italian influences (through the application of the mandate provisions) were still being applied by the Maltese Courts. The

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<sup>421</sup> 30/05/2001 (Court of Appeal – Superior) Cit Nru. 82/1990/1

<sup>422</sup> 31/10/1983

Court of Appeal, however, went further, by making reference to Professor Andrew Muscat's assertion whereby he argues that it is customary to include a clause to state that the directors may carry out any other act deemed necessary to further the company's objective to ensure that ratification shall not be required for every act carried out by a director that goes beyond his powers.

The same approach and interpretation taken under the 1962 Ordinance were again retained with the coming into force of the 1995 Maltese Companies Act. In the Maltese judgment *Francis Busuttil and Sons Limited v Christopher Apap and Reflex Computer Systems (Malta) Limited*,<sup>423</sup> the judges reached the conclusion that ratification shall take place for the company to be bound by any act done by a director that is beyond his powers. The Court of Appeal made reference to the mandate provisions and also noted that should ratification not take place, the director would then be personally bound by that act.

The importance of ratification was again discussed by the Maltese Courts in *Deirdre and John Cachia v Gaba Diamonds Company Limited*.<sup>424</sup> The claimants alleged that they had entered into a private agreement with the defendant company in 1996. The defendant company had been given, under a lease, premises in Msida. The upshot of the action was that the claimants alleged that the defendants had terminated the lease without notice, resulting in damages being suffered. The defendant company responded that one of the two directors alone did not have power to solely sign the private agreement in question; instead, such an agreement had to be signed by both as clearly provided by the memorandum and articles of association of the

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<sup>423</sup> 30/05/2014 (Court of Appeal) Cit. Nru 331/1997/1

<sup>424</sup> 28/11/2003 (Court of Appeal) Cit. Nru 2227/1998/1

claimant company. The First Hall Civil Court did not make specific reference to the ratification principle as regulated by the law of mandate, but still held for the defendant because the lease had not been signed by both directors of the defendant company, as was specifically required by the memorandum and articles of association of the claimant company.

The importance of tacit ratification was again referred to by the Maltese Courts in *Carmen Aquilina et v Edgar Ellul*.<sup>425</sup> In this case, the Maltese Courts held that the English approach to tacit ratification was to be adopted, although the same interpretation arises under the law of mandate. The Maltese Courts specifically decided that, in the case of a tacit ratification, there shall be two prerequisites: firstly, whoever is consenting to such ratification is fully aware of what they are doing; secondly, any person involved is aware of all the effects of that act of ratification.

There may be other circumstances in which a director acts within the limitations of the mandate, but does not explicitly show that they are acting on behalf of the company. In such a case, a director is also automatically personally liable. This is not regulated by the statute law of mandate, nor by any Maltese Commercial Ordinance or Act. However, Maltese case law has dealt with this situation and can therefore be relied on to illuminate the significance of the application of this limitation. The first judgment to deal with this notion was in 1914. Before then, one might have expected that, if an act fell within the limitations of the mandate, the company would be bound by that act even if the director did not expressly show that he was acting on behalf of the company, since the director could have been acting within the limits of

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<sup>425</sup> 17/03/2003 (Court of Appeal)

the mandate. However, in *Salvatore Coleiro v John Ellis*<sup>426</sup> the Maltese Courts made it clear that if an express announcement was not made by the director to the third party, the company should not be bound by that act, even if that act fell within the limitations of the mandate given. The Court held that a mandatary is freed from their obligations only under three circumstances: if the mandatary manifests his power of attorney; if the mandatary at least declares that they do not want to be personally liable; or when the third party is aware of the mandator's presence. Although fifty-two years passed until the same question was again raised before the Maltese Courts, the same principle was again applied whereby in *Emmanuele Farrugia v Giovanna Lughermo*,<sup>427</sup> the Court stated once again that if the mandatary does not explicitly show that they are acting on behalf of another person, one must presume that they are acting in their own name.<sup>428</sup> This same principle was again rebutted, as presented in the judgments *John Vella noe v Anthony Vella et*<sup>429</sup> and *Anthony Caruana et v John Magro et*, among others.<sup>430</sup> It was held in these latter two judgments that when a person contracts in his own name, he cannot then subsequently state that he is contracting in the name of another person or in the name of a legal person that is separate and distinct from its shareholders.

Once more, the mandator in this case shall be interpreted as including the company, as represented by the body of shareholders through the interpretations provided above.

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<sup>426</sup> 4/2/1914 (Court of Appeal) Vol. XXI.i.93

<sup>427</sup> 29/10/1956 (Court of Appeal – Civil Section)

<sup>428</sup> See also *Philip Galea Souchet v Michael Falla* (04/05/1973) (Commercial Court – Appeal), *Frank Cilia noe v Charles Scicluna* (27/04/1992 (Commercial Court)), *Joseph Chetcuti noe v Peter Paul Camilleri* (04/12/1998 (Commercial Court of Appeal)), *Executive Services Ltd v Therese Agius* (14/12/2001 (Tribunal Court)) Cit Nru 1062/2001/1.

<sup>429</sup> 03/12/1999 (Court of Appeal)

<sup>430</sup> 06/10/1999 (Court of Appeal)

#### 4.4 The statutory fiduciary duty of directors after 2003

After 2003, the statutory fiduciary duty of directors began to be solely regulated by Article 136 A of the Maltese Companies Act 1995. This Article lists different general duties, all of which can be grouped under one duty – the fiduciary duty<sup>431</sup> – except for the duty of care, skill and diligence. Although the Maltese legislators made no explicit assertions to this effect, this provision was influenced by the English legal system for two reasons. Firstly, the wording of the Maltese provision is very similar to the sections in the United Kingdom Companies Act 2006. Secondly, when one considers the timeframe of the enactment of the Maltese provision (the Maltese provision passed in 2003, while the English developments with respect to the fiduciary duty of directors were taking place in the late 1990s and early 2000s), it can be seen that the Maltese provision was highly influenced by the English developments. Nevertheless, differing interpretations under these two legal systems arise in certain instances because the Maltese provision was passed and in force before the United Kingdom Companies Act 2006.

The statutory fiduciary duty of directors under the Maltese Companies Act 1995 was endorsed in *Advocate Doctor Jean C Farrugia noe v Aqua Oasis Limited (C 41157) et*,<sup>432</sup> in which the Maltese Courts held that directors are strictly bound by such duty. The claimant, who held 50% of the shares in the defendant company, claimed that the company was being unilaterally managed by the other defendant, Dorte Rickert, who held the other 50% of the shares in said

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<sup>431</sup> David Cabrelli, Presentation for Università Bocconi on the Reform of the Law of Directors' Duties in UK Company Law, The Edinburgh Law School <[http://www.law.ed.ac.uk/includes/remote\\_people\\_profile/remote\\_staff\\_profile?sq\\_content\\_src=%2BdXJsPWh0dHAIM0EIMkYIMkZ3d3cyLmxhdy5lZC5hYy51ayUyRmZpbGVfZG93bmxvYWQIMkZwdWJsaWNhdGlvb nMIMkYxXzQ4NV90aGVyZWZvcmlvZnRoZWxhd29mZGlyZWV0b3JzZHV0aWVzaW51a2NvLnBkZiZhbGw9MQ%3D%3D](http://www.law.ed.ac.uk/includes/remote_people_profile/remote_staff_profile?sq_content_src=%2BdXJsPWh0dHAIM0EIMkYIMkZ3d3cyLmxhdy5lZC5hYy51ayUyRmZpbGVfZG93bmxvYWQIMkZwdWJsaWNhdGlvb nMIMkYxXzQ4NV90aGVyZWZvcmlvZnRoZWxhd29mZGlyZWV0b3JzZHV0aWVzaW51a2NvLnBkZiZhbGw9MQ%3D%3D)> accessed 4 June 2015. Cabrelli also takes the approach that the duty of loyalty encapsulates all duties that arise under article 136A CA 1995, except for the duty to exercise the degree of care, diligence and skill that would be exercised by a reasonably diligent person

<sup>432</sup> 16/10/2015 (First Hall Civil Court) Cit. Nru. 651/2008

company. The claimant claimed that Rickert was not properly managing the company, and that her actions were affecting the claimant as a shareholder. The company was formed with the aim of taking over the administration and operation of a dive centre that was to be transferred from a Danish company in the name of the claimant. He also claimed that he had financed the new defendant company, either personally or through his Danish company. The claimant started to suspect that mismanagement was occurring in the new company and asked for a shareholders' meeting, but this was never held, and the claimant was never able to get hold of the information that he was requesting. He claimed that Rickert had unilaterally decided, as sole director of the defendant company, to re-transfer the dive centre to another company without having obtained approval at a shareholders' meeting. The Courts reached the conclusion that the defendant has failed to abide by her duties under Article 136 A of the Maltese Companies Act 1995 when the re-transfer of the dive centre to the new company took place; thus, she was held to be in breach of her fiduciary duty.

#### **4.4.1 Duty to act in good faith and in the best interests of the company**

Article 136 A of the Maltese Companies Act 1995 provides, as a first rule, that '[a] director of a company shall be bound to act honestly and in good faith in the best interests of the company'. This is considered the core duty that should be observed by directors,<sup>433</sup> and is therefore categorised as the most significant part of the fiduciary duty of directors. This part of the duty entails that a director must act genuinely and in the best interests of the company.

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<sup>433</sup> Davies (n 196) 506

To fully comprehend the interpretation of this duty under the Maltese legal system, reference to the English legal system shall be made, since Maltese legislators decided to enact this particular duty after considering that it was also very noteworthy in the English legal system, as analysed above. In fact, this duty is very similar to that stipulated under the English legal system. Section 172 of the United Kingdom's Companies Act 2006 refers to 'the duty to promote the success of the company', which can also be referred to as the no-fettering principle. The first part of Section 172 very much resembles the Maltese approach, as it lays down that '[a] director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company'. Consequently, both statutory provisions provide that a director must act in good faith and in the best interests of the company.

On closer inspection, however, one can see two differences between the Maltese and English provisions. First, from a terminological point of view, the Maltese provision speaks of 'well-being' and the United Kingdom Act of 'success'. 'Well-being' does not necessarily include success, but rather to efficient operation whereas success implies that such person shall obtain a positive result from a particular action, as both terms are defined by the Oxford Dictionary.<sup>434</sup> Second, the English position makes it evident that the subjective element of this duty is placed on the director, since the director is required to act in good faith and in the way they believe is best; by contrast, the Maltese provision does not explicitly make reference to the subjective approach, therefore implying that an objective approach is sought wherein a director must act in the way that any reasonable person would act in the same position. This subjective approach

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<sup>434</sup> The word 'wellbeing' is limited to the fact of comfort, whereas the term 'success' is amplified to include the accomplishment of something: Lexico, Oxford Dictionaries, wellbeing and success <<https://en.oxforddictionaries.com/definition/well-being>> accessed 10 April 2017 and <<https://www.lexico.com/en/definition/success>> accessed 10 April 2017

was given great prominence by the United Kingdom government during the 1990s and 2000s and was considered a crucial element for the specific wording used in this provision.<sup>435</sup> Such wording was used to codify the long-standing common law position, which also puts emphasis on the subjective element enjoyed by the directors and holds that the company directors' decisions cannot be questioned by any court if it is shown that they acted in good faith and in the company's best interests. This common law approach was presented in the English case *Re: Smith and Fawcett Ltd.*<sup>436</sup> Smith and Fawcett formed a company together and article 10 of the articles of association provided that the directors enjoyed the discretion to opt not to register a share transfer. After Fawcett's death, Smith applied this provision of the company's articles of association and declined to register the share transfer in the name of Fawcett's heirs. Lord Greene MR acknowledged that 'A director must exercise their discretion bona fide in what they consider (not what the court does) is in the best interests of the company and not for a collateral purpose'. The same approach was again applied by Parker J in *Regentcrest plc v Cohen*:<sup>437</sup> whereby he said that

'The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind'.<sup>438</sup>

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<sup>435</sup> Explanatory notes prepared by the Department of Trade and Industry (DTI) and published along with the Act, which express the Government's intention that '*the decision as to what will promote the success of the company, and what constitutes such success, is one for the director's good faith judgement*' <[http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpgaen\\_20060046\\_en.pdf](http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpgaen_20060046_en.pdf)> accessed 3 March 2016

<sup>436</sup> [1942] Ch 304. Vide also *Jonathan Ball v Eden Project Ltd* [2001] All ER (D) 128 (Apr), in which the claimant registered a trademark in his name which was owed to the company

<sup>437</sup> [2001] 2 BCLC 80

<sup>438</sup> David Kershaw, *Business Judgments in UK Corporate Law*. In *The Foundations of Anglo-American Corporate Fiduciary Law* (2018) (International Corporate Law and Financial Market Regulation, pp. 39-67) Cambridge: Cambridge University Press. doi:10.1017/9781316135891.003

Consequently, it is an established principle that if directors act in good faith and in the best interest of the company, they can never be held to be in breach of this duty, even if they make a mistake or act unreasonably, so long as the company's best interests are preserved. Nevertheless, due to its subjective application, this duty may be prone to abuse in the sense that what one director considers to be in good faith and in the best interest of the company might not be considered so by another, with the result that the company's best interests might not always be fully protected. Indeed, Gower and Davies observe that it is difficult to show that directors have broken this fiduciary duty to act in good faith and in the best interests of the company, and that directors are usually found in breach of this fiduciary duty only 'in egregious cases or cases where the directors, obligingly, have left a clear record of the thought processes leading up to the challenged decision'.<sup>439</sup> The Courts have displayed willingness to interfere with the directors' decision only when it is evidently observed that the best interests of the company are not taken into consideration. This strict approach was clearly adopted in the English judgment *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*.<sup>440</sup> The defendant company was set up to manage three flats in London. Mr Palmer and Eaton Bray Ltd owned one share each in this company, but had a history of not getting along. The claimant company, owned by Gwyer, owned one flat on the ground floor; Mr Palmer and Eaton Bray Ltd also owned a flat each. Gwyer nominated his builder to the board of directors of the defendant company. An agreement was ultimately reached between Gwyer and Palmer and a resolution was passed in favour of the agreement. However, Eaton Bray Ltd sued, arguing that the resolution was ineffective as there had been a breach of the fiduciary duty to act in good faith and in the best interest of the company. The Court accepted the argument presented by

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<sup>439</sup> Davies (n 196) 377

<sup>440</sup> [2003] BCC 885

Eaton Bray Ltd, and found that the best interests of the company were not protected, since the directors had acted in their own best interests rather than those of the company.

The same strict approach was again applied in the English case *Re W & M Roith Ltd*.<sup>441</sup> However, in this judgment, the Court went even further, holding that it had a duty to interfere when the directors, despite not acting with conscious dishonesty, still might not be taking the best interests of the company into consideration. In these instances, the Courts may find the directors to be in breach of their fiduciary duty since the best interests of the company would not be protected. Roith was a director of the defendant company who entered into a service contract with his company on the basis that, upon his death, his wife would be entitled to a pension. However, the Courts found that Roith had not acted in the best interests of the company in this instance, and thus held that the transaction was not binding on the company, even though Roith did not act with conscious dishonesty.

As opposed to the English system, the Maltese statutory provision seems to make reference to the objective approach when interpreting the good faith principle as regards directors; in reality, however, the Maltese Courts' reluctance to interfere with the directors' decisions seems to be due to their approach of having opted to apply the subjective element, since it was only recently that the Maltese Courts began to question directors' decisions. In view of this, much like under the English legal system, the Maltese Courts interfered only when the best interests of the company proved not to have been protected to the required extent. The first case to have dealt with the application of this fiduciary duty was *Emanuel Chircop pro et noe v Carmel sive*

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<sup>441</sup> [1967] 1 WLR 4321

*Charles Busuttil et.*<sup>442</sup> In this case, the claimant was holder of half of the shares of Continental Postform Ltd, while the defendant, Busuttil, held the other half. They were also the only two directors of this company. Chircop alleged that Busuttil was in charge of the company's financial position and that he, Chircop, had realised that mismanagement was taking place. Regrettably, the defendant did not bring forward an argument and the only defence argument was that the claimant's action should not be proceeded because the company itself should have been the claimant. However, although the company was not the claimant itself, the Court still held that the claimant's action shall stand and decided that any director of a particular company has a duty to ensure that any other director acts in good faith and in the best interests of the company, and that in cases of breach of this fiduciary duty, a director may bring an action against another director to protect the company's interests.

Two years later, the Maltese Courts again unequivocally held in *Oreste Cilia pro et noe v Daniel Cilia pro et noe et*<sup>443</sup> that directors are bound to act in good faith and in the best interests of the company, and that the Courts are bound to interfere when the company's interest is not protected to the extent that it should be. The claimant, Oreste Cilia, alleged that he was a shareholder and a director of the defendant company, Cilia Products Limited. The other two directors and shareholders were Daniel and Maurice Cilia, who were joined to the action. Oreste Cilia had agreed with the other defendants that he would work fifty hours every two weeks for the company, whereas the other defendants were to work eighty hours every two weeks for the same company. However, Oreste Cilia later unilaterally decided to start working eighty hours every fortnight, a decision to which the other two defendants objected. Oreste

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<sup>442</sup> 12/11/2013 (First Hall Civil Court) Cit. Nru. 1223/1997/1

<sup>443</sup> 08/01/2015 (First Hall Civil Court) Cit. Nru. 735/2004

Cilia also discovered that the other two defendants were taking sums of money from the company's funds as compensation, and had also given compensation to other employees without the approval of the board of directors. The First Hall Civil Court found that a director is required to abide by their fiduciary duty to act in good faith and in the best interests of the company, which enhances the relationship of trust between the directors and the company. The Court found that directors must put the company's interests at the core of every decision they take, and upheld the claimant's argument that he had every right to be present for board of directors' meetings as a duly appointed director to ensure that the best interests of the company were protected.

The importance of this fiduciary duty was again discussed by the Maltese Courts a few months later in *Advocate Doctor Jean C Farrugia noe v Aqua Oasis Limited (C 41157) et.*<sup>444</sup> In this case, the Maltese Courts went one step further in the interpretation of this part of the fiduciary duty: they specifically stated that even though the defendant was the only director of the defendant company, Aqua Oasis Limited, she still had the duty to act in good faith and in the best interests of the company. The Maltese Courts found that the defendant was in breach of this duty when she unilaterally and without prior approval of the shareholders decided to transfer the business of the dive centre to another company.

The significance of the fiduciary duty of directors to act in good faith and in the best interest of the company was discussed again in *Architect Raymond Vassallo pro et noe et v Anthony Parlato Trigona et.*<sup>445</sup> In this case, two of the defendants voted during a board of directors'

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<sup>444</sup> 16/10/2015 (First Hall Civil Court) Cit. Nru. 651/2008

<sup>445</sup> 30/09/2016 (Court of Appeal) Cit. Nru. 716/11

meeting for a payment to be vested in them. The Court held that the defendants' behaviour as directors was neither in good faith nor the best interests of the company. Despite this, the defendants were acquitted because the claimants did not properly file the action.

Again, the same strict interpretation of this fiduciary duty was confirmed in *Jane Chircop et v Robert Mizzi pro et noe et.*<sup>446</sup> The claimants alleged that Mizzi and David Mifsud used to work as property consultants with the company Sapphire Real Estate Services, which was managed by Chircop. Mizzi, Mifsud and the other employees acquired a property and decided to transfer it to a second company R&D Developments Limited, which was wholly owned and managed by Mizzi and Mifsud, instead of transferring it to Sapphire Real Estate Services. Mizzi and Mifsud never registered the other employees as shareholders and directors of the company in question. Eventually, R&D Developments Limited transferred its rights to R&S Developments Limited, a company incorporated on 10<sup>th</sup> August 2007 by Mizzi, who was also the sole shareholder and director. The Court held that Mizzi and Mifsud had not complied with their duty to act in good faith<sup>447</sup> when they did not transfer the acquired property to the claimant company.

Such duty to act in good faith and in the best interest of the company is, however, statutorily limited in its application under the English legal system, as opposed to the Maltese legal system and to the subjective element that is at the core of the interpretation of this duty, under Section 173 in the Companies Act 2006, which is entitled as the duty to exercise independent judgment.

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<sup>446</sup> 27/04/2017 (First Hall Civil Court) Cit. Nru. 459/14

<sup>447</sup> Reference was also made to *Edward and Giovanni Leone Enriquez v Dr Anthony Farrugia et* (First Hall Civil Court) (12/10/1989)

This provision, in fact, entails that directors are bound to act in the best interests of the company without feeling any pressure to decide in one manner rather than another, but are nevertheless bound to act in accordance with the company's constitution or any agreement that is in force, and not by what they subjectively perceive to be in good faith and in the best interests of the company. This exception to this fiduciary duty of directors solidified the English Court's approach, as was discussed at great length in *Boulting v Association of Cinematograph, Television and Allied Technicians*.<sup>448</sup> This case concerned two managing directors of a film company who applied for a declaration not to be eligible to join the defendant association, as they claimed that they were only performing management functions and were therefore not bound to join. The defendant association, however, claimed that the two directors were still required to be part of its association under a trade union agreement. The Courts decided that this part of the fiduciary duty should be observed to protect the company, and not the directors, and that their membership was to protect the company and its employees.

This prohibition was again considered by the English Courts, even before the official enactment of the statutory provision, in *Thorby v Goldberg*.<sup>449</sup> In this case, the directors agreed to allot shares in a particular way within a wider restructuring scheme. However, they failed to abide by the scheme and even claimed that such agreement breached the no-fettering rule. As a consequence, an action was filed to force them to honour the agreement. The Court decided against the directors, declaring that when they had entered into this agreement, they had surely taken into consideration the best interests of the company; therefore, the agreement was valid and should be honoured by the directors.

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<sup>448</sup> [1963] 2 QB 606

<sup>449</sup> (1964) 112 CLR 597

Again, the strict application of the fiduciary duty of directors to compel them to act in accordance with any agreement they might have reached, if it is proven that they have acted in the best interest of the company, was applied in *Fulham Football Club v Cabra Estates plc*.<sup>450</sup> This case concerned an agreement entered into between the parties, in which the claimant bound itself not to oppose any future applications for planning permissions that the defendant might make; in return, the claimant was paid a substantial amount of money. However, the club later wanted to rescind this agreement and tried to argue that its board of directors had fettered their discretion and not acted in the best interest of the company. The Court found for the defendant, asserting that the claimant's directors had entered into the agreement after having assessed the benefits to the company and after having exercised their fiduciary duty properly. Accordingly, the club remained bound by the agreement, which was to be honoured.

However, at around the same time, the English Courts made it clear that any agreement reached by the directors should still take the best interests of the company into account; otherwise, the Courts may still find a particular agreement to be void, as was shown in *Kregor v Hollins*.<sup>451</sup> Hollins invested a sum of money and agreed to pay remuneration to Kregor to act as his nominee director. The Court held that, even though Kregor had been appointed by Hollins, he was under strict obligation to act in the best interests of the company and its shareholders, not in the sole interest of Hollins. The Court thus annulled the agreement reached between the two.

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<sup>450</sup> [1994] BCLC 363

<sup>451</sup> (1913) 109 LT 225

Nevertheless, these statutory provisions shall not hinder any director who might prefer to seek professional advice to be better guided to fully protect the best interests of the company. Lord Goldsmith, then Attorney General, clearly felt that directors should be able to seek any advice they wish, without fearing that they are contravening their fiduciary duty to act in good faith and in the best interests of the company, or indeed breaching any agreement that might have been put in place by the directors and any other third party. He summed up this duty succinctly in Parliament by stating that:

‘the clause does not mean that a director has to form his judgement totally independently from anyone or anything. It does not actually mean that the director has to be independent himself. He can have an interest in the matter [...] It is the exercise of the judgement of a director that must be independent in the sense of it being his own judgement [...] The duty does not prevent a director from relying on the advice or work of others but the final judgement must be his responsibility. He clearly cannot be expected to do everything himself. Indeed, in certain circumstances directors may be in breach of duty if they fail to take appropriate advice – for example, legal advice. As with all advice, slavish reliance is not acceptable, and the obtaining of outside advice does not absolve directors from exercising their judgement on the basis of such advice’.<sup>452</sup>

Although the Maltese position differs slightly from the English in this aspect, it would seem that the same approach would be applied by the Maltese judiciary were the issue to be addressed. This is because the English legal system was resorted to when drafting the new Article 136 A; accordingly, if the Maltese Courts were to be faced with similar circumstances,

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<sup>452</sup> Cabrelli (n 431). He cited Lord Goldsmith, Lords Grand Committee, 6 February 2006, column 282, Hansard.

it is the English legal system and the approach taken by the English Courts that would surely be followed.

However, although the interpretation and limitations of this fiduciary duty with respect to directors can be determined to be similar under the two systems, there are some diverging interpretations between these systems with respect to the term ‘company’. At first glance, it seems that the fiduciary duty as enlisted under Article 136 A (1) of the Maltese Companies Act 1995 shall only be a duty for the interests of the company, and that any other stakeholder’s interest shall be disregarded. It would seem that the Maltese legislators wanted to strictly apply the principle of the company’s separate legal personality. Accordingly, the way the fiduciary duty is drafted under Article 136 A (1) seems to provide that if directors take any decision which is important for the company but not for the shareholders or any other stakeholder, they would have still acted correctly and within the parameters of the law. The reason behind this approach is because the Maltese legislators did not make any reference to any other stakeholder; had they wanted to include any other stakeholder, they would have explicitly included them so as to avoid any misinterpretation. Such stringent interpretation was indeed applied and followed by the Maltese Courts in *Dr Victor Emanuel Ragonesi v Albert Stagno Navarra et.*<sup>453</sup> The defendant, in the name of the company Heritage Estates Limited, obliged himself by a promise of sale to transfer and sell a property to Alexander Kazitsine. The full amount was paid on the signing of the promise of sale, but this sum of money was to be returned to the claimant in the event that the sale could not take place due to any fault impugned to the defendant company. The First Hall Civil Court found that the directors of the company were required to act in good faith and in the best interests of the company, but also in the best

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<sup>453</sup> 09/01/2009 (Court of Appeal) Cit. Nru. 771/2001/3

interests of shareholders and creditors, especially when the company might become insolvent. However, the Court of Appeal overturned this ruling, finding that the directors of a company owe their fiduciary duty to the company only, and not to any creditors or shareholders. At first glance, a similar approach can be seen under the English legal system, in which the Law Society emphasises the principle that the company is a separate legal entity and believes that the interests of the company should be protected above the interests of any other party.<sup>454</sup> Section 170 of the Companies Act 2006 also affirms that the directors owe their fiduciary duty to the company. This strict interpretation of the parties to whom this duty is owed was also applied in *West Mercia Safetywear Ltd v Dodd*,<sup>455</sup> in which the Court explained that the creditors' interests should only come into play if the company is insolvent. Section 172 also presents a situation that implies that directors shall first take into account the best interests of the company, which enjoys a separate legal personality from its shareholders, and only after these company interests have been taken into account shall they consider the other interests listed in Section 172. This situation thus seems to indirectly imply that in cases of conflicting interests, the interests of the company shall primarily always prevail. Such rationale is further enhanced because Section 172 also has its origin in the common law fiduciary duty of directors, and shall therefore be defined as a duty to act in what directors believe to be the best interests of the company.<sup>456</sup>

Nevertheless, other papers published in the English legal system during the 1990s and the 2000s started to take into consideration the question of ESV and CSR principles (vide Chapter

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<sup>454</sup> Company Law Reform White Paper, March 2005 <<https://www.treasurers.org/ACTmedia/file13958.pdf>> pp. 6

<sup>455</sup> [1988] BCLC 250

<sup>456</sup> Andreas Ruhmkorf, *Corporate Social Responsibility, Private Law and Global Supply Chains* (1<sup>st</sup> edn, Edward Elgar Publishing Limited 2015)

2). The ESV principle was formulated during the comprehensive review of English company law by the Company Law Review Steering Group in 1999. This principle entails that the directors of the companies should also act in the collective interest of the shareholders, and in the interests of the company.<sup>457</sup> This principle is to be applied to all shareholders equally.<sup>458</sup> These changes can be seen in Section 172 of the Companies Act 2006, which embodies the ESV principle.<sup>459</sup> Andrew Keay points out that Section 172 (1) enshrines that the shareholders' interests are primary<sup>460</sup> and any other stakeholder cannot enforce this provision against the directors because this fiduciary duty is owed to the company and to its members; thus, this statutory provision can only be enforced either by the company or by the shareholders through a derivative action.<sup>461</sup> Ruhmkorf, furthermore, believes that stakeholder interests can only be taken into consideration if they will also benefit from such behaviour.<sup>462</sup> It thus seems that the CSR principle is subordinate to the principle of ESV. The CSR principle mainly refers to the importance of directors taking the interests of every stakeholder into consideration when acting in the name of the company<sup>463</sup> and Pillay believes that Section 172 indirectly provides room for the application of the CSR principle.<sup>464</sup> Nevertheless, it seems that not all legal scholars agree with this approach (vide Chapter 2). These two diverse but complementary principles were incorporated into English statute law by Section 172 of the Companies Act 2006, which provides a non-exhaustive list that must be observed by directors when they are required to

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<sup>457</sup> A.R. Kaey, *The Enlightened Shareholder Value Principle and Corporate Governance*, (1<sup>st</sup> edn., Routledge 2012). While shareholders and employees were already protected under the 1985 Act article 309 (1), the new English provision expands these interests to also include, among others, creditors and the environmental impact.

<sup>458</sup> Farrar and Hannigan (n 328) 377

<sup>459</sup> The Changing Nature of Corporate Social Responsibility: CSR and Development in Context – The Case of Mauritius by Renginee Pillay p 102

<sup>460</sup> Ibid.

<sup>461</sup> Ruhmkorf (n 456)

<sup>462</sup> Ibid.

<sup>463</sup> David Crowther and Guter Aras, *Corporate Social Responsibility* (1<sup>st</sup> edn., Guler Aras & Ventus Publishing ApS 2008) 10

<sup>464</sup> Renginee Pillay, *The Changing Nature of Corporate Social Responsibility: CSR and Development in Context – The Case of Mauritius* (1<sup>st</sup> edn, Routledge 2016) pp. 10

make decisions about the best interests of the company. This approach was affirmed by Nourse LJ in *Brady v Brady*,<sup>465</sup> in which he held that ‘The interests of a company, as an artificial person, cannot be distinguished from the interests of the persons who are interested in it’. In this case, two brothers were taking care of the company’s business, which consisted of both haulage and drinks businesses. However, a disagreement ensued between the two, who were also the major shareholders of the company. The decision was reached that one of them would retain the drinks business and the other would retain the haulage business. Restructuring was therefore inevitable if these two businesses were to continue to flourish. However, the claimant alleged that the granting of financial assistance for the purchase of its own shares was not in the best interests of the company. The House of Lords ruled that such financial assistance would be for the benefit of the company and also for the benefit of the creditors in the long run. The same reasoning was again applied in *Winkworth v Edward Baron Development Co Ltd*.<sup>466</sup> This approach shows that, if the interests of the stakeholders are well-protected, the interests of the company will also be automatically protected and flourishing. However, one other problem with the list provided in Section 172 is that neither the law nor any related guidance notes provide information on what happens if one factor competes with another, and in such a case, which should have primacy.<sup>467</sup>

In Malta, neither the ESV nor the CSR principles were ever explicitly included in any statutory provision. However, should the Maltese Courts be faced with the need to interpret the statutory provision of Article 136 A of the Companies Act 1995, this interpretation will likely be strongly

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<sup>465</sup>[1988] BCLC 579

<sup>466</sup> [1986] 1 WLR 1512

<sup>467</sup> Ruhmkorf (n 456)

influenced by the amendments to the English legal system for the reasons outlined above.<sup>468</sup> Additionally, these two principles have been introduced in Malta with respect to listed companies in June 2006,<sup>469</sup> but are still considered only ancillary, since the Companies Act 1995 shall always prevail over the interpretation and application of these listing rules. These two principles have led to a distinction in Malta between listed companies and other companies. One reason for this could be that listed companies are made up of different shareholders who trade their shares on a continuous basis and of directors who are generally not shareholders. Moreover, listed companies may also issue bonds by means of which not only the normal day-to-day creditors, but also the bondholders who lend their money to the company will be protected. Companies that are not listed usually have a structure in which the shareholder role and the director role are interchangeable and are usually vested in the same person. Although companies that are not listed can still have shareholders who are distinct and separate from the directors, these are typically small and medium-sized companies (vide Chapter 1) in which the major shareholder and the sole director are usually the same person. Accordingly, the ESV and CSR principles are automatically applied by the director, as they would be also indirectly acting in their best own interest should the company's financial position flourish. The Maltese mentality, especially the interpretation applied by the Maltese Courts, is also changing in favour of the applicability of these two principles in all cases, such that the interests of the company and the interests of other stakeholders are to be equally protected, as demonstrated in *Jane Chircop et v Robert Mizzi pro et noe et*<sup>470</sup> where the Court reiterated the principle that

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<sup>468</sup> These two principles, especially the CSR principle, is very much pronounced under the wrongful and fraudulent trading, as also presented in the Maltese judgment Advocate Doctor Andrew Borg Cardona noe v Priceclub (Holdings) Limited et (First Hall Civil Court 24/3003 – 12/10/2007)

<sup>469</sup> Malta Financial Services Authority, Listing Rules <<https://www.mfsa.com.mt/pages/viewcontent.aspx?id=267>> accessed 10 July 2018

<sup>470</sup> 27/04/2017 (First Hall Civil Court) Cit. Nru. 459/14

directors owe their fiduciary duty not only to the company, but also to the shareholders and the creditors.

#### **4.4.2 Duty to promote the wellbeing of the company and responsibility for its general governance and supervision**

Article 136 A (2) of the Maltese Companies Act 1995 enlists another part of the fiduciary duty that must be thoroughly observed by directors, which is to:

‘promote the well-being of the company and be responsible for:

- (a) the general governance of the company and its proper administration and management; and
- (b) the general supervision of its affairs’.

The statutory wording of this duty is straightforward, such that the directors must ensure that the company is always in a profitable position and has the least amount of debt possible.

This duty has only been partially discussed by the Maltese Courts. To a certain extent, it was dealt with in *Advocate Doctor Jean C Farrugia noe v Aqua Oasis Limited (C 41157) et*<sup>471</sup> and in *Architect Mariello Spiteri v Registry of Companies et.*<sup>472</sup> In this latter case the claimant claimed that, although he was one of the defendant company’s directors, he did not have any access to the company’s accounts and was contesting part of the fine that had been imposed on him as one of the directors by the Registry of Companies. He asserted that the company was in

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<sup>471</sup> 16/10/2015 (First Hall Civil Court) Cit. Nru. 651/2008

<sup>472</sup> 15/01/2015 (First Hall Civil Court) Cit. Nru. 778/2008

reality managed by its two other directors, who were also defendants in this case. However, the Registry of Companies contended that all the directors were liable for the late filing of the accounts and had an obligation to act jointly as one board of directors. Reference to this specific fiduciary duty that binds every director without exception was, consequently, made in the Registry's reply. The Court rejected the claimant's argument and, while agreeing with the Registry of Companies' argument, ordered him to pay his share of the fine.

This duty seems to be based on Section 172<sup>473</sup> of the United Kingdom Companies Act 2006, entitled 'the duty to promote the success of the company', discussed above. However, one distinction between the Maltese and English legal systems is that the Maltese legislators decided to enact two distinct but complementary duties: the duty to act in good faith and in the best interests of the company, and this particular duty. By contrast, the English legislators only enacted the duty as enshrined under Section 172,<sup>474</sup> and have consequently linked the good faith principle with the duty to promote the well-being of the company. Maltese legislators have never provided an answer as to why they adopted such an approach. The reason might be that, although the Maltese legislators relied heavily on the English consultation papers and debates, the official Maltese provision was enacted before the English one; accordingly, the Maltese provision could not be enacted in exactly the same manner as the English provision. The Maltese legislators might also have decided to enact two duties because the interpretation of the duty to act in good faith and in the interests of the company goes beyond that of general governance, since general governance only implies the smooth running of the company and not the fiduciary duty to take certain decisions in the best interests of the company.

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<sup>473</sup> Vide Section 172

<sup>474</sup> Ibid.

After the interpretation of this duty is established, one other difficulty involves interpreting the party to whom the directors owe this fiduciary duty. The term ‘company’ seems to be wholly limited to the company that enjoys a separate legal personality from both its shareholders and any other stakeholder under the Maltese legal system. However, the ESV and the CSR principles are today endorsed under the Maltese and English legal systems and the term ‘company’ shall, therefore, be construed accordingly.

#### **4.4.3 Duty not to make secret or personal profit without the consent of the company, nor make personal gain from confidential company information**

Article 136 A (3) (b) of the Maltese Companies Act 1995 provides for directors not to make any gain, including any profit, from their position. This Maltese provision may be regarded as being formulated with reference to Section 176<sup>475</sup> of the United Kingdom Companies Act 2006, which provides for the duty not to accept benefits from third parties. However, the English statutory provision is more liberal than the common law approach or the Maltese Article for two reasons. Firstly, the English common law approach and the Maltese provision do not differentiate as to whether those profits or gains are generated through the company or a third party, whereas the English provision only limits the acceptance of such gains or profits if they are earned through a third party that is not the company. Secondly, whereas the common law approach and the Maltese provision include any profit and any misuse of information, irrespective of any conflicts of interest that might arise between the directors and the company,

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<sup>475</sup> Vide Section 176

Section 176 only comes into play when such conflicts of interests between these two divergent parties emerge.

Nevertheless, the common ground between each approach seems to be that immaterial benefits such as Christmas gifts are always classified as gifts (even though neither the Maltese nor the English legal systems have ever given its explicit opinion on this notion)<sup>476</sup> and are therefore prohibited if they arise in the manner outlined above.

To better understand this duty, it is necessary to split it into two parts: the making of profit or gain; and the misuse of information. With regards to the first, the common law approach of the no-profit rule shall apply. This prohibits any director from gaining any secret information or personal profit that may be derived from holding the position of director. The English Courts have been applying this rule with a certain degree of rigidity for many years, as is illustrated *Bray v Ford*,<sup>477</sup> discussed above.

This duty was, however, circumvented under the common law approach, as under the Maltese statute law, in that the company's consent is considered vital if a director is to be permitted to profit or gain from his professional position; as we saw in *Regal (Hastings) Ltd v Gulliver*.<sup>478</sup> This principle applies in English law even if the directors act without malice to gain such profit. The English Courts therefore decided that a director may make profits, as long as the company

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<sup>476</sup> This presumption is my own, based on previous analyses of the statutory provisions under the Maltese and English legal systems

<sup>477</sup> [1896] AC 44

<sup>478</sup> [1942] UKHL 1. See Section 4.3.4

is aware of it and gives its consent. In *Regal*, the House of Lords found the former directors liable for the damages incurred by the companies, because even though the directors had acted in good faith, they had also used their position and knowledge as directors to turn a profit without the consent of the group of companies. Lord Russell of Killowen stated that:

‘The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of bona fides; or upon such questions or considerations as whether the profit would or should otherwise have gone to the claimant, or whether the profiteer was under a duty to obtain the source of the profit for the claimant, or whether he took a risk or acted as he did for the benefit of the claimant, or whether the claimant has been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account’.<sup>479</sup>

Nevertheless, this part of the fiduciary duty does not seem to prohibit a director from being paid by the company, or by another person, so long as the company consents to such gain, since directors would otherwise never be paid for their work. However, one major problem with such consent is that the company is managed by directors, meaning that the company cannot in any real sense make its own decisions. Accordingly, the directors themselves make decisions about their own personal gain while showing that they are making decisions on behalf of the company that they manage. Nevertheless, at the same time, it must be noted that the definition of the company is nowadays interpreted in light of the ESV and CSR principles, and so shareholder approval will be sought. Taking the stakeholders’ interests into account is also important, as it will ultimately result in a profit for the shareholders. Another problem that arises under this

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<sup>479</sup> Andrew Bowen, ‘Director’s Duties of “No Conflict” and “No Profit” Re Allied Business and Financial Consultants Ltd [2009] 2 B.C.L.C. 666’, n Greens Business Law Bulletin, Issue 105 (published April 2010)

duty is that the Maltese Courts have never been asked to interpret this fiduciary duty. In view of all this, recourse to the English statute and case law is practicable in this instance to understand this duty.

As to the second part of the prohibition, which tackles the misuse of information, the Maltese approach seems to be that gain through the use of such confidential information, even with the company's consent, should never take place. One perfect example of misuse of information is when insider dealing takes place when a director misuses the company's information for their own personal benefit. This statute provision seems to reflect the English common law approach, but not that of the English statutory provisions. Accordingly, recourse to the common law approach through case law shall once more be made to shed light on the best and most accurate interpretation of this duty. In *Industrial Development Consultants Ltd v Cooley*<sup>480</sup> (vide Section 4.3.5) the Court held that the defendant was accountable to the company because he had based his own personal decision on misuse of information obtained while he was the managing director of the claimant company.

A recent case that again clearly dealt with this part of the fiduciary duty is the English judgment *Gencor ACP Ltd v Dalby*.<sup>481</sup> The claimant brought this action against the defendant for misappropriation of funds. The defendant was a former director of the claimant company, which alleged that the defendant had made a secret profit at its own expense through the misuse of information. The defendant had indeed received payment from a third party, Balfour Beatty, which was directed to a British Virgin Island Company under his sole control, for opportunities

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<sup>480</sup> [1972] 1 WLR 443

<sup>481</sup> [2000] EWHC 1560 (Ch)

he had diverted from the claimant company to his personal company. In view of this, the Court held the defendant accountable for the claimant company's loss, and the defendant was made to repay the profit. In addition to the above, it is observed that nowadays, this prohibition is also rigorously regulated by the Market Abuse regime (vide Chapter 2).

However, these two English cases do not provide the answer as to whether a gain or a profit through the misuse of information can be acceptable if the company consents to it. Nonetheless, it could be argued that such an approach is not acceptable even if the company gives its consent, as whenever there is misuse of information, the relationship of trust enjoyed between the director and the company is breached.

As a result, it must be noted that the difference between the first and second part of this fiduciary duty is that if directors gain secret or personal profits by making use of their position, but do not indirectly steal anything that belongs to the company, such behaviour may be somehow accepted; however, if the director steals information that solely belongs to the company, such behaviour is unacceptable and categorized as improper. This strict interpretation seems to also be accepted by the Maltese statutory provision, because if the consent of the company would have been enough to ratify such a situation, this provision would have been enacted differently.

Moreover, this duty continued to be complemented under the Maltese legal system with Article 127 of the Ordinance 1962, and was later replicated as Article 144 of the Maltese Act 1995, which provides for the prohibition of loans to directors, which article has already been analysed above.

#### **4.4.4 Duty not to let personal interests conflict with the interests of the company**

This fiduciary duty arises both under Articles 145 and 136 A (c) of the Maltese Companies Act 1995, which lays down that a director shall ensure that his personal interests do not conflict in any manner with the interests of the company and is thus not competing with the company. Due to the fact that two provisions were enacted by legislators in Malta to regulate the same part of fiduciary duty, this does beg the question as to why the Maltese legislators felt the need to enact another statutory provision when this duty seems to have already been provided for by statute. However, closer inspection shows a crucial difference between these two statutory provisions in that Article 136 A (c) is more general and not only limited to contracts, unlike Article 145. Consequently, Article 136 A (c) can also cover other situations that might arise in virtue of the director's position.

Nevertheless, both provisions shall be interpreted as including any prohibition of directors competing with the company; therefore, both positive and negative competition is prohibited outright. It will thus include those instances in which the director does not act at all in circumstances in which they should have acted. In such instances, therefore, directors would be considered to be in a position of indirectly competing with the company. One example might be when a director, having employed a member of their family at the company, learns that this family member is not up to standard, and yet keeps them on.

The Maltese Courts had the opportunity to deal with the interpretation of this part of the fiduciary duty defined under Article 136 A (c) in *Advocate Doctor Jean C Farrugia noe v Aqua*

*Oasis Limited et*,<sup>482</sup> (vide Section 4.4). In this case, the Court held that Rickert had acted in breach of her fiduciary duty not to compete with the company Aqua Oasis Ltd from the date when the board of directors decided to transfer the diving operations to another centre.

As with the other parts of the fiduciary duty as arising under Article 136 A, this duty was also very much influenced by the English legal system, precisely by the common law. In fact, Muscat<sup>483</sup> notes that this duty was incorporated under Article 136 A of the Maltese Companies Act 1995 due to the long-standing approach taken by the English Courts and their successful interpretation using the equitable no-conflict rule, as demonstrated in *Aberdeen Railway Co v Blaikie Bros*<sup>484</sup> (vide Section 4.3.4), together with the interpretation and application of this duty as defined herein.

The same strict interpretation of this duty was also recently considered in the United Kingdom in *Crown Dilmun v Sutton*.<sup>485</sup> The claimant, together with Dilmun Investments Ltd, was part of the Bahrain International Bank group of companies. The defendant, a director in both companies, had been able to make them both into successful ventures. However, the group of companies ran into difficulties and instructed the claimant and Dilmun Investments Ltd to sell their investment properties as soon as possible. During this process, a good opportunity arose to purchase and develop the Craven Cottage Football Stadium; however, the defendant decided to divert that opportunity to Fulham River Projects Ltd, a company which he and his wife

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<sup>482</sup> 16/10/2015 (First Hall Civil Court) Cit. Nru. 651/2008

<sup>483</sup> Muscat (n 31) 444

<sup>484</sup> [1854] UKHL 1.

<sup>485</sup> [2004] All ER (D) 222 (Jan).

owned almost half, instead to the other two companies he was managing. As a result, the claimant successfully brought an action for damages against the defendant.

This common law approach was fortified through Section 175 of the United Kingdom's Companies Act, entitled 'duty to avoid conflicts of interest'. The importance of this statutory provision was also dealt with by the English Courts, as exemplified in *Shepherds Investments Ltd and Shepherds (Financial) Ltd v Andrew Walters*.<sup>486</sup> The defendants were all former directors or senior employees of the claimant, an investment fund that traded in individual life insurance policies. The defendants, while still in the employ of the claimant company and without its authorisation, began to discuss the creation of a new investment fund to compete in the traded life policy market. The defendants opted to focus on a slightly different section of the market than the claimant and had carried out the required research and made important contacts. In view of this evidence, the Court concluded that this duty should be interpreted to hold that a director cannot in any manner either directly or indirectly compete with the company. The defendants were consequently held liable for their actions.

At first glance, it seems that this English statutory provision provides for two situations in which conflicts of interest cannot arise, as opposed to the Maltese statutory provision, which is more generic. The English provision provides that such a duty is not infringed in situations that are not reasonably seen as likely to give rise to a conflict of interest. One problem with such an exemption, however, is that a subjective element is applied when assessing whether or not a particular case falls under the prohibition in question. Nevertheless, at the same time, the

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<sup>486</sup> [2006] EWHC 836.

term 'reasonable' leads to an objective approach. The English provision also provides that this fiduciary duty will not be breached by the director if the matter has been authorised by the company. In this respect, the English provision is also able to recognise the significant differences between a private and a public company: the constitution of a private company shall not in any manner invalidate such authorisation, whereas in the case of a public company, such authorisation shall be specifically laid down in the company's constitution. Again, this exemption does not seem to fit with the principles of corporate law, because the company is managed by directors, and this exemption allows them to make decisions for their own benefit on behalf of the company. Again, this exemption may be challenged in today's field of corporate law, since the ESV and CSR principles have become common considerations and have changed the classic conception of a company.

This fiduciary duty to avoid any conflict of interest was also supplemented under the English statute law with the enactment of Section 177<sup>487</sup> of the Companies Act 2006, which provides for the situation in which directors are required to declare their interests in any proposed contracts or arrangements with the company. This section also provides that both direct and indirect interests<sup>488</sup> shall be disclosed, such as when a remuneration package for a particular director is decided. This duty is enshrined under the Maltese legal system under Article 145.<sup>489</sup>

Nevertheless, the English statute law has gone one step further than the Maltese legal system in regulating this fiduciary duty, as it has enhanced the importance of this duty through the

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<sup>487</sup> Vide Section 177

<sup>488</sup> Davies (n 194) 533-534. Davies interpreted an indirect interest as one that includes a situation wherein a director is required to disclose the fact that he is also a shareholder of the proposed arrangement

<sup>489</sup> Vide Article 145

enacting of Section 170 (2).<sup>490</sup> This section states that the duty to avoid conflicts continues to apply to a director even after his retirement from office as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director. This specific interpretation is not explicitly expressed under any Maltese provision that regulates the fiduciary duty of directors; however, if the Maltese Courts were to be faced with such a situation, it is likely that the same approach and interpretation as the English legal system will be adopted because the interests of the company must always be protected.

The final issue is to whom the parties bound by this fiduciary duty are answerable. The term ‘company’ is nowadays interpreted in terms of the ESV and CSR principles and not looked upon as a separate legal entity on its own, particularly in the case of a one-man company where the separate legal personality of the company and the ESV principle very much overlap. The CSR principle is also taken into consideration as regards the long-term profit that would be enjoyed by the company (vide Chapter 2).

#### **4.4.5 Duty not to use any property, information or opportunity of the company for personal or anyone else’s benefit or obtain any benefit from their power, except with the consent of the company at the general meeting or as permitted by the memorandum and articles of the company**

This duty was included under Article 143<sup>491</sup> of the Maltese Companies Act 1995 and again included under Article 136 A (3) (d).<sup>492</sup> At first glance, it can be seen that the Maltese

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<sup>490</sup> Vide Section 170 (2)

<sup>491</sup> Vide Article 143

<sup>492</sup> Vide Article 136 (A) (3) (d)

legislators decided to enact this specific duty under Article 136 A to ensure that any relevant circumstance not covered by other parts of the fiduciary duty or related statutory provisions will still be regulated. Indeed, the two provisions differ in the sense that, while Article 143 is limited to competition, Article 136 A is more generic which also includes other circumstances in which direct or indirect competition might be difficult to prove. Another major difference between the two is that Article 136 A provides for authorisation to also be sought under the memorandum and articles of the company and not only at a general meeting.

However, at the same time, these provisions are similar in two aspects. Firstly, both allow consent to be given at a general meeting of the company. While the Maltese legislators wanted to emphasise the importance of shareholder consent, since they are the ultimate beneficiaries of the company, this may be difficult to achieve. In a large company with a lot of shareholders, it might be impractical to obtain consent from the majority of the shareholders. By contrast, in a small company, the major shareholder is usually also the director, or even more so, companies that are single member companies. Secondly, both provisions were enacted to account for the no-conflict and no-profit rules, as also discussed above.

Although this fiduciary duty is very much important to be thoroughly observed by directors, it was only partially addressed by the Maltese Courts in *Mark Hogg noe v Terra Sana Ltd et.*<sup>493</sup> In this case, the claimant, one of the shareholders of Terra Sana Ltd filed this action because he believed that the management of the defendant company was not acting in accordance with its fiduciary duty as detailed under this statutory provision. He alleged that a certain amount of

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<sup>493</sup> 31/10/2016 (First Hall Civil Court) Cit. Nru. 607/13

money was being invested by the defendant company, but that the shareholders were never fully informed of the circumstances and were never asked for approval. The defendants counter-argued that they had submitted documents to the shareholders detailing where the money was being invested. The Court held that, although it was true that the defendants had presented some documentation to the shareholders, this documentation only referred to one year and the defendants had used other documentation containing the company's information for their own benefit. The defendants were therefore in breach of this particular provision.

Due to the limited interpretation of this duty under the Maltese legal system, reference to the English legal system seems practical for the reasons outlined above. This duty as formulated under Article 136 A of the Maltese Companies Act 1995 very much reflects Section 175<sup>494</sup> of the United Kingdom Companies Act 2006, which also provides for authorisation when there is or appears to be a conflict of interest between the directors and the company, albeit with one difference. While the Maltese provision does not limit such authorisation to the company's constitution but also gives such a right to the general meeting, the English position is limited to the company's constitution. Although a company's constitution may easily be amended through a general meeting, the Maltese approach is slightly easier to implement, as authorisation is automatically provided for in the general meeting rather than first requiring an amendment to the constitution before authorisation can be obtained.

Once more, should it be examined to whom the directors owe this fiduciary duty, it is observed that this duty favours the company as defined through the ESV and CSR principles. Even more

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<sup>494</sup> Vide Section 175

so due to the fact that the Maltese law places great significance on the shareholder consent, because any changes to the memorandum and articles of association can only be approved by the shareholders at a general meeting, and consent can also only be attained at a general meeting.

#### **4.4.6 Duty to exercise the powers they were given and not to misuse those powers**

The diverse parts of the fiduciary duty are also restricted by the duty to act within the powers conferred upon them, as provided for under Article 136 A (3) (e) of the Maltese Companies Act 1995, as also discussed in the Maltese judgment *Enemalta Corporation v Vella Group Limited and John Mary Vella*.<sup>495</sup>

This statute provision, once again, is very similar to Section 171<sup>496</sup> of the United Kingdom Companies Act 2006, which also provides for a restriction on the directors to the extent of any action that may be taken by a director in the best interests of the company. When directors act beyond the scope of the powers conferred on them, the company must carry out ratification if the directors are not to be personally liable for those acts. The English statutory provision has codified the long-standing common law approach. In this respect, Lord Hodge recently affirmed that:

‘I am supported in my opinion by Lord Glennie in *West Coast Capital (Lios) Ltd Petr* [2008] CSOH 72, (at para 21) in which he expressed the view that Section 171 of the 2006 Act did little more than set out the pre-existing law on the subject. I also derive some support from leading company law textbooks

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<sup>495</sup> 08/06/2006 (Court of Appeal) Cit Nru. 1837/2004/1

<sup>496</sup> Vide Section 171

such as *Gore-Browne on Companies* (at para 15 [8A]) and *Palmer's Company Law*, which (at para 8.2309) suggests that older cases remain relevant to the interpretation of the statutory duties since the codified duties are generally formulated in a way that quite faithfully reflects the older case law. The statutory formulations do not, by a side wind, alter the law of agency or prevent ratification of the unauthorised acts of a director'.<sup>497</sup>

The problem of directors acting beyond their powers has long been a much debated issue in the English legal system; even the common law approach has faced such challenges. An example of such infringement was analysed by the English Courts in *Punt v Symons & Co Ltd*.<sup>498</sup> In this case, the articles of association gave the governing director the power to appoint and remove the other directors, and his power was subsequently executed by his executors when he died. Unsurprisingly, friction arose between the executors and the directors and the directors decided to rescind the articles of association by means of a special resolution. To ensure that an affirmative outcome could be reached on this resolution, the directors issued new shares to five additional members. The executors requested an injunction to prohibit the company from holding the meeting, which was granted by the Court, which decided that the issuing of these new shares constituted an abuse of power by the directors, as it was clear that these new shares had been issued to control the minor shareholders. This judgment was followed in *Piercy v Mills & Co Ltd*.<sup>499</sup> In this case, the directors had issued shares with the object of creating a sufficient majority to enable them to resist the election of three additional directors, whose appointment would have put the two existing directors in a minority position. Peterson J held

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<sup>497</sup> UK: Scotland, Companies Act 2006 – Directors' Duties and Board Ratification considered in the Outer House <<http://simplewebpagesoflaw.blogspot.com/2012/04/uk-scotland-companies-act-2006.html>> accessed 10 June 2016

<sup>498</sup> [1903] 2 Ch. 506

<sup>499</sup> [1920] 1 Ch. 77

that the directors were not entitled to use their power to issue shares merely for the purpose of maintaining their and their friends' control over the affairs of the company, or merely for the purpose of defeating the wishes of the majority of shareholders. A similar approach was again applied in the judgment *Hogg v Cramphorn Ltd*,<sup>500</sup> in which the directors of a company faced with a takeover proposal established a trust and allocated sufficient shares to the trustees to defeat the takeover. Buckley J held that, as the power to issue shares was a fiduciary one, it could not be exercised for an improper purpose. This decision was stricter than that in *Punt* because, in the latter judgment, the Courts decided that they would have accepted the issue of shares if it were for a purpose that would have resulted in a benefit to the company. Another English judgment that came to a comparable conclusion is *Lee Panavision Ltd v Lee Lighting Ltd*.<sup>501</sup> The claimant company acquired an option to purchase the defendant company in 1988. At that time, the claimant and defendant entered into a management agreement such that the claimant was to run the defendant's business and nominate its directors. This agreement expired when the option to purchase the defendant's shares expired. The claimant did not want to purchase the shares, but still wanted to manage the defendant, and a second management agreement was signed for the original directors to be removed and new directors appointed by the defendant. However, the defendant later did not want to be bound by this second agreement. The Court of Appeal found in favour of the defendant, asserting that the outgoing directors could not enter into such an agreement since this was beyond their powers, because the incoming directors would have no say in the matter.

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<sup>500</sup> [1967] Ch. 254

<sup>501</sup> [1992] BCLC 22 (C.A.)

One question that arises from the abovementioned judgments is that of how to fully understand whether or not directors have acted beyond the scope of their powers. In *Teck Corp Ltd v Millar*,<sup>502</sup> the English Courts clarified the notion that a look at the company's interests is required to fully understand whether the directors have acted beyond their powers. It was held that, if an issue of shares was carried out for the benefit of the company, it must be accepted. The case involved a takeover in which the directors of the target company issued shares to another company with a view to defeating the takeover. The claimant brought proceedings against the directors to prevent the issue of these new shares and Berger J ruled that 'the impropriety lies in the directors' purpose. If their purpose is not to serve the company's interest, then it is an improper purpose'.<sup>503</sup>

Although one might think that directors act beyond their power for a pecuniary gain, the English Courts clarified the notion that even if there is no pecuniary gain or the directors do not directly benefit from any pecuniary gain there might be circumstances of directors acting beyond their powers if the interests of the company are not taken into consideration. In *Howard Smith Ltd v Ampol Ltd*,<sup>504</sup> it was held that, even if the directors do not personally gain, they may still be in breach of their duties by having acted beyond their powers if the company's interests were not properly protected. This case also concerned the power of directors to issue new shares. The directors did not want the company to be taken over and therefore issued new shares; hence, in this instance, even though the directors would not have personally gained from such a move, the purpose of the share issue was solely to dilute the majority voting power.

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<sup>502</sup> (1972), 33 DLR (3d) 288 (BCSC)

<sup>503</sup> Michael St. Patrick Baxter, 'The Fiduciary Obligations of Directors of a Target Company in resisting an Unsolicited Bid', 63 Ottawa Law Review/Revue de droit d'Ottawa 20 (1)

<sup>504</sup> [1974] UKPC 3

The Court held that these directors acted for an improper purpose. A similar approach was applied in *Extrasure Travel Insurances Ltd v Scattergood*<sup>505</sup> which concerned the power of directors to deal with corporate assets. The directors of the claimant company had transferred company funds, amounting to around £200,000, to Citygate Insurance Brokers Ltd, another company in the group and the parent company, to enable it to pay a creditor. It was held that the directors had acted for an improper purpose, and whether the company's interest was adequately protected was key in determining whether the directors had acted for an improper purpose.

The problem defined under this fiduciary duty has been to a certain extent resolved under the English law following the introduction of the 2006 Companies Act, which contains the stipulation that an objects clause does not need to be enacted in the memorandum and articles of association. Directors are therefore not limited in any manner, and are to act in what they solely believe is the best interests of the company. Regrettably, this English initiative was not followed by Maltese statute law; as a consequence, the principle of ratification remains fairly significant under the Maltese legal system, even though a fairly wide objects clause is usually listed in the memorandum and articles of association of the company when the company is first registered with the Registry of Companies; the wider the power of the director, the more difficult it is to understand whether or not the director's actions were improper.

There may also be other instances where directors do not act beyond their powers, but simply act in their own personal name. In such circumstances, whenever a director acts in his own

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<sup>505</sup> [2003] All ER (D) 364 (Nov)

name, he will be personally liable, that such contracts must be performed by the director in his personal capacity and not by the company. The Maltese Courts have, however, not been faced with such a situation since 2003.

After establishing the interpretation of this fiduciary duty as applied to directors, it is also significant to observe that directors shall correctly use their powers not only as proposed by the company and in the best interest of the company, but also as dictated by any shareholder and stakeholder; thus implying that the ESV and CSR principles shall apply in this respect once again, as already analysed above.

#### **4.5 Directors' statutory fiduciary duty as applied under Articles 1124 A and B of the Maltese Civil Code 1870 and as interpreted by the Courts**

Articles 1124 A and B, as influenced by Roman law, were introduced under the Maltese Civil Code 1870 in 2004 to cover any type of fiduciary relationship, and are therefore not limited to the relationship between directors and companies. Article 1124 A specifies that fiduciary obligations may arise by virtue of a contract or even by assumption of office. This means that whenever a person is appointed to act for the benefit of the company but does not exclusively hold the title of director, that individual must still be bound by the strict interpretation and application of the fiduciary duty, which is defined in a very similar way to the other statutory provisions so far analysed. Accordingly, these two provisions as arising under the Maltese Civil Code 1870 would regulate chief executive officers, chief financial officer or general managers, by way of example, since they would be considered as de facto directors.

The Maltese Courts recently had the opportunity to interpret this duty in the context of companies in *Anthony Caruana and Sons Limited et v Christopher Caruana*.<sup>506</sup> The claimant company filed the action because it felt aggrieved by the defendant's behaviour. It alleged that the defendant had been employed by the claimant company as a general manager between 2003 and 2006, under an employment contract. As a general manager, the defendant had the responsibility to sell and carry out marketing activities for a variety of products that were imported by the claimant company. The company also asserted that the defendant was also responsible for the other employees. Consequently, the claimant company believed that although the defendant did not hold the exclusive title of a director, and Article 136 A of the Maltese Companies Act 1995 could not apply, he was still bound by Article 1124 A of the Maltese Civil Code 1870 and was accordingly bound by the strict observance of fiduciary duty. The defendant rebutted the claimant's claims on the basis that he had terminated his employment in 2004, and since Article 1124 A was introduced in 2004 but only came into force from 1st January 2005, the provision could not apply. The Court made reference to Article 1124 A and stated that any person who is considered to be a fiduciary is under strict obligation to ensure that any information received by his position shall be retained confidential, and that also has a duty to act in the best interest of the person who had appointed them. The Court made reference to the English judgment of *University of Nottingham v Fishel*<sup>507</sup> and was of the opinion, even if not correctly applied, that the concept of fiduciary obligations had been introduced into the Maltese legal system due to English influences. This English case concluded that an employment relationship is not a fiduciary one and that the fiduciary duty shall therefore not apply. Additional reference was made to earlier Maltese judgments that established that an employee may compete with the employer after terminating the contract.

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<sup>506</sup> 28/02/2014 (Court of Appeal) Cit Nru. 573/2005/1

<sup>507</sup> [2000] EWHC 221 (QB) (19 January 2000)

Accordingly, the First Hall Civil Court dismissed the claimant's case. However, the claimant company felt aggrieved and appealed. The Court of Appeal made reference to various Maltese judgments and legal scholars when determining that Articles 1124 A and B of the Maltese Civil Code 1870 had not introduced a new concept into the Maltese legal system, but rather clarified the situation; the defendant was, therefore, bound by the fiduciary duty, and the earlier finding was overturned.

The same strict interpretation of this fiduciary duty was reached a few months later in *Vascas Enterprises Limited v Adrian Ellul*.<sup>508</sup> The claimant company alleged that the defendant had been employed by them as a manager, and that his contract of employment was dated 18<sup>th</sup> June, 2008. It alleged that after terminating his employment in 2010, the defendant made use of confidential information about the claimant company to open his own personal business. The Court made specific reference to the English judgment *Ranson v Customer Systems plc*,<sup>509</sup> which dealt with a similar scenario. In that case, the English courts drew a distinction between a fiduciary duty and the duty of fidelity. The Court pointed out that every employment contract is based on the duty of fidelity, which implies that an employee shall act in the best interest of the employer during the term of his employment, but that this does not prohibit the employee from looking at other opportunities that might be beneficial to him. The Courts also pointed out that the fiduciary duty is more onerous, as it means that directors, or anyone who is considered to be a fiduciary, must act in the best interests of the company without reservation or limitation. The Maltese Courts once again made reference to *University of Nottingham v Fisher*<sup>510</sup> and to *Helmet Integrated Systems Ltd v Tunnard*,<sup>511</sup> which made the same point that

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<sup>508</sup> 13/11/2014 (First Hall Civil Court) Cit. Nru. 111/2011

<sup>509</sup> [2012] EWCA Civ 841

<sup>510</sup> [2000] EWHC 221 (QB) (19 January 2000)

<sup>511</sup> [2006] EWCA Civ 1735

an employment contract is not based on the fiduciary duty; however, it also made reference to *Anthony Caruana and Sons Limited v Christopher Caruana* and also to Professor Joseph A. Micallef, both of which suggest that a manager should not be regarded as an ordinary employee, but he shall be looked at as having an additional fiduciary duty much like any other director. The Court, as in the earlier Maltese judgment, made reference to Article 1124 A of the Civil Code 1870 and stated that this Article has only crystallised the Maltese position which has been in existence from the enactment of the Roman law: this Article asserts that the fiduciary duty may arise out of contract, out of the law itself, or due to the position held by the person. Accordingly, the Court decided that any employee, including a manager, is required to observe the fiduciary duty in a manner as strict as any other director. Nevertheless, in this particular case, the Maltese Courts decided that the defendant did not breach his fiduciary duty because he did not act while in employment, and therefore dismissed the claimant's claim.

However, it is imperative to remember that with respect to the relationship between directors and company, these two provisions act as ancillary to Article 136 A of the Maltese Companies Act 1995, something confirmed by the Maltese Courts in *Amadeo Balzan v Central Holidays (Travel and Tourism Ltd)* and *Alexandra Balzan Ruggier et.*<sup>512</sup> The claimant was one of the three shareholders of the defendant company, Central Holidays (Travel and Tourism Limited), and the other two shareholders were the other two defendants. The claimant had also been a director of the defendant company until the other two shareholders voted him out. He alleged that these actions were taken against him because he and one of the defendants, Alexandra, had been married, but had commenced separation proceedings. The claimant stated that the defendant company had been in operation since the 1980s and that he had always held the

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<sup>512</sup> 16/06/2015 (First Hall Civil Court) Cit. Nru. 581/2011

position of director. The company in question was a family business, but in 1991, after he married Alexandra, the claimant's father suggested that since the claimant had always been the sole mind behind the company, it should be fully transferred to him. However, due to legal restrictions at that time, the claimant decided to subscribe shares both in the name of his wife and also in the name of his wife's father. Reference to Article 136 A of the Companies Act 1995 and to Articles 1124 A and B of the Maltese Civil Code 1870 was made by the claimant. The Court held that, whereas Article 136 A of the Companies Act 1995 should be considered the *lex specialis*, Articles 1124 A and B of the Maltese Civil Code 1870 constituted *lex generalis*. In light of this, the Maltese Courts stated that the two sets of Articles could not be tied together. The Court also rejected the claimant's pleas on the basis that he was no longer a director of the company and was therefore not in a legal position to bring an action under Article 136 A.

#### **4.6 Conclusion**

The Maltese legal system, through its application of the statutory mandate provisions, greatly influenced the regulation of the fiduciary duty of directors until 2003. Provisions of the Italian civil legal system were copied more or less verbatim to form the Maltese statutory mandate provisions, and only two very minor differences existed between the Italian and the Maltese legal systems. Under the Maltese provisions, the statutory application of the mandate provisions differ from their Italian counterpart in two instances whereby the mandatary has certain restrictions when to sue and be sued when the mandator is present in the country but the mandatary can act directly against a third party that they personally contract with. The other difference between the Maltese and Italian mandate provisions is with respect to the interpretation provided to the term 'company' as widely interpreted by some of the Maltese

judiciary to also include shareholders and to not restrict such term to the strict interpretation of the separate legal personality enjoyed by the company. However, by the time of the enactment of the 1962 Maltese Ordinance, the influence of the English legal system had begun to make its presence felt, and new concepts began to be introduced into the Maltese legal system. Certain specific provisions such as the duty not to let personal interest conflict with the interests of the company were written into the Maltese Ordinance time and were required to be strictly observed by the directors. These provisions, as influenced by the English system, led to a revolution as they had to be applied instead of the general mandate provisions. From that moment onwards, the Maltese legal system began to blend the Italian and English legal systems and apply them at the same time, depending on which part of the fiduciary duty was being debated.

2003 was a major milestone for the Maltese statutory legal system, as it was at this point that the decision was made to resort only to the English legal system. However, because the Maltese legislators had decided to enact the formal statute law before the final statutory English provisions were enacted, different interpretations apply in various instances. One such example is where the English statutory legal system included a provision stating that even after retirement from office, a director is still bound by certain duties, an inclusion considered to be very important for protecting the company that was managed by that individual, and which will surely be included through interpretation into the Maltese legal system.

Again, the principle of protecting the company's financial position as much as possible was so important for the Maltese legislators that 2004 marked another major milestone due to the introduction of the general fiduciary concept in the Maltese Civil Code 1870. From then on,

any individual who exerts a certain degree of financial control over a company is required to observe the same onerous fiduciary duty as any other person who explicitly holds the title of director.

# **Chapter 5. The Maltese Courts and their conflicting interpretations of the fiduciary duty of directors**

## **5.1 Introduction**

The aim of this chapter is to examine the approach taken by the Maltese Courts when interpreting and applying the different statute laws enacted throughout these past 200 years in cases concerning the fiduciary duty of directors of limited liability companies. It analyses each *res judicata* judgment that has dealt with the issue and a summary of the judgment is also presented. Regrettably, it is only through such descriptive interpretations that one can fully appreciate and comprehend the problems presented by the Maltese judiciary.

It will demonstrate that the Maltese Courts have not always applied the correct statute law at that particular moment in time. It will, accordingly, be presented that certain judges and magistrates applied the law correctly, but others who also form part of the judiciary, unfortunately, misapplied the law, with the result that it would have made a difference who the judge was appointed to a particular case whose actions and decision affected the involved parties, sometimes in an unlucky manner.

To fully understand the conflicting interpretations provided by the Maltese Courts, the cases that will be referred to hereunder will be duly divided according to the date when they were firstly filed before the Maltese Courts because that date shall determine which statute law should have been applied, and not when the judgment was delivered by the said Courts.

Nevertheless, this study will firstly outline the Maltese Court system, by making emphasis on the Court sections that directly decide on issues relating to the interpretation and application of the fiduciary duty of directors, to fully understand in which Court an aggrieved person has the duty to file an action for it to be decided upon and not be dismissed. A concise summary of the statutory development of the fiduciary duty of directors under the Maltese legal system shall thereafter be provided to appreciate which law the judiciary should have applied at that particular moment in time.

The analyses presented in this chapter, however, has three limitations. First, it does not take into consideration cases, which were not *res judicata* as at the time of writing, because one can only analyse a judgment after the final decision has been reached and not merely on any proofs that the parties may have brought forward. Second, this study does not include unreported cases since these cases are unknown to any third party and cannot be analysed. Third, only judgments that specifically deal with the directors' fiduciary duty are examined.

## **5.2 The Maltese judicial system**

The judicial system in Malta was created by Maitland and his Royal Commission of 1812.<sup>513</sup> This Commission created different categories of Courts, which are still around today. The judicial system is regulated by Chapter 12 of the Laws of Malta, entitled the Code of Organisation and Civil Procedure.<sup>514</sup> It is composed of the Constitutional Court, the Court of

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<sup>513</sup> VassalloMalta, 'Maltese History and Heritage' <<https://vassallohistory.wordpress.com/the-legal-system/>> accessed 10 July 2015

<sup>514</sup> Chapter 12 of the Laws of Malta <<http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8577&l=1>> accessed 15 May 2015

Appeal, the Superior Courts and Inferior Courts.<sup>515</sup> The Inferior Courts are sat on by magistrates whereas judges sit in the Superior Courts, with the result that a person can appeal from a decision delivered by a magistrate to the Superior Courts, whereby judges have the ultimate word and whose judgment cannot be further appealed with the result that there is only the possibility for one time appeal. The Maltese judicial system is also composed of various Boards and Tribunals which are established by the Minister of Justice for a specific purpose, and which may also be led by advocates rather than judges and magistrates.

However, as noted above, for the purpose of this analysis, only a historical overview of the Commercial Court will be examined, together with today's composition and function of the First Hall Civil Court, of the Court of Magistrates in its Superior Jurisdiction, of the Court of Appeal and the Small Claims Tribunal.<sup>516</sup> Consequently, this analysis shall only be limited to those courts that are faced with the interpretation of the fiduciary duty of directors.

### ***5.2.1 The Court of Appeal***

The Civil Court of Appeal hears appeals on cases from the First Hall Civil Court and by the Court of Magistrates. The composition of the Civil Court, however, differs according to where the case was first filed. If the appeal was filed from the First Hall Civil Court, the Court of Appeal is composed of three judges. If the appeal originates from the Court of Magistrates in its inferior jurisdiction, the Court of Appeal is composed of only one judge.

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<sup>515</sup> Vide Article 2

<sup>516</sup> Other courts, such as the Civil Court (Family Section) or the Civil Court (Voluntary Jurisdiction) exist, but are not relevant to this study

The decisions reached by the Court of Appeal cannot be further appealed and are consequently considered as definite and conclusive.

### ***5.2.2 The First Hall Civil Court***

This Court is presided over by one judge. The First Hall Civil Court hears all cases of a civil and commercial nature, which exceed the jurisdiction of the Court of Magistrates. The main distinction between the two Courts is that all claims where the disputed sum is more than €11,646.87 or where the claim cannot be quantified must be filed and tried by the First Hall Civil Court. Accordingly, if a particular action is filed before the Court of Magistrates, the penalty awarded cannot exceed the indicated sum herein. The First Hall Civil Court also hears all cases that deal with constitutional matters, which are regulated by the European Convention on Human Rights and by the Maltese Constitution.

This Court is, however, defined differently in Gozo, which is the sister island of Malta and the only other inhabited island of the Maltese archipelago<sup>517</sup> which has its own judicial system in certain aspects. In Gozo, in fact, the First Hall Civil Court is not present, but the Court of Magistrates (Gozo) in its Superior Jurisdiction enjoys the same jurisdiction, powers and functions as exercised by the First Hall of the Civil Court in Malta, with the exception that it cannot hear cases in which a breach of fundamental human rights is alleged.

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<sup>517</sup> It is clarified that another island that forms part of the Maltese archipelago, Comino, is only inhabited by one person as at to date

### ***5.2.3 The Commercial Court***

This Court used to hear cases of a commercial nature only with appeals to lie with the Court of Appeal, which description of this Court is provided above. It was, however, disestablished in 1995 and superseded by the First Hall Civil Court.

### ***5.2.4 The Small Claims Tribunal***

This Tribunal was established in 1995 and shall have jurisdiction to hear and determine all money claims of an amount not exceeding five thousand euro (€5,000), including those in relation to the interpretation and application of the fiduciary duty of directors.<sup>518</sup>

## **5.3 The applicable law to directors**

Before the enactment of Article 136 A of the Companies Act 1995 and its ancillary fiduciary law provisions in the Maltese Civil Code 1870, mandate law and any other specific provision enacted in the Commercial Ordinances or Acts was applicable to interpret the fiduciary duty of directors (vide Chapter 4). However, the Maltese Courts, sometimes, felt compelled to also refer to the English approach and English judgments when there was an issue not properly covered by mandate law or even to further interpret and apply mandate law appropriately. Although mandate law and its ancillary fiduciary law differs from the fiduciary law as interpreted under the English legal system, recourse to the English law was common for two reasons. First, because Maltese lawyers are aware that:

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<sup>518</sup> Article 3 (2) of Chapter 380 of the Laws of Malta, <<http://justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=8847&l=1>> accessed 28 March 2018

‘English company law has formed the backbone of Maltese company law for almost half a century, instilling in the process a *forma mentis* amongst Maltese professionals and lawmakers that is ingrained in English company law concepts’.<sup>519</sup>

Secondly, because:

‘legislative developments in the United Kingdom are, in part, driven by the British government’s desire to maintain London’s status as a pre-eminent financial centre. To a considerable extent, therefore, the United Kingdom has been, and will continue to be, perceived in Malta as an attractive model in matters of company law’.<sup>520</sup>

With the enactment of Article 136 A of the Companies Act in 2003 and its ancillary fiduciary provisions in 2004 in the Maltese Civil Code 1870, any reference to mandate law should have become obsolete and the Maltese Courts were bound to refer and apply the new laws. Yet, the Maltese Courts sometimes challenged these new provisions and have occasionally applied the wrong interpretations by referring to mandate law after 2003.

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<sup>519</sup> Muscat (n 31) 57

<sup>520</sup> Ibid. 57

### 5.3.1 Cases filed before 2003

#### 5.3.1.1 *Applicability of mandate law or any other provision enacted in the Commercial Ordinances or Acts that supersedes the law of mandate*

The first judgment in which mandate law was correctly applied dates back to the 19<sup>th</sup> century which is *Francesco Saverio Musu' v Vincenzo di Saverio Vella et.*<sup>521</sup> In this case, the Maltese Commercial Court resorted to mandate law and declared that the directors of the company shall be considered mandataries of that company. This judgment also established that according to the Maltese doctrine and jurisprudence, these administrators, as directors, have to be considered mandataries of the company and also of each and every shareholder.

The same correct interpretation was applied in *Victor Grima noe v Anthony Grech*,<sup>522</sup> in which mandate law was again applied when interpreting the fiduciary duty of directors. The defendant was the director of a company and enticed customers to end their relationship with the company to enter into a new relationship with him. In view of this, the Court of Appeal noted that Grech's behaviour went against his fiduciary duty towards the company, and he was, therefore, liable for the damages suffered by the claimant company.

Another judgment that simply applied the law of mandate when interpreting the application of the fiduciary duty of directors is *Salvatore Schembri v Salvatore Gauci*.<sup>523</sup> Gauci was appearing as a director of the defendant company and signed a promise of sale for and on behalf of the company with the claimant on 17 November 1978. The Commercial Court held that Gauci had

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<sup>521</sup> Vol. XII B page 527 (11/11/1890)

<sup>522</sup> 09/12/1968 (Court of Appeal)

<sup>523</sup> 31/10/1983 (Commercial Court)

an obligation to ensure that the conditions of the memorandum and articles of association of the company were abided by, one of which was that any document that binds the company had to be signed by both two directors. However, the promise of sale was not signed by both directors. Accordingly, the Commercial Court held that Gauci, as the director and mandatary of the defendant company, did not ensure that any document is signed by the two directors. The Commercial Court, furthermore, decided that the company did not ratify this promise of sale and he was, therefore, personally liable for the promise of sale entered into with the claimant.

In *John Veglio v Catherine Camilleri*,<sup>524</sup> the law of mandate was again correctly applied when interpreting the fiduciary duty of directors. As a result, the Court of Appeal stated two important factors: firstly, that a director has to act in the best interest of the company and when doing so they are not acting in their own name; and secondly that a director shall be considered as the mandatary of the company. The defendant had worked for a company of which the claimant was a director. However, the defendant had her employment terminated and decided to seek a precautionary warrant against the claimant personally as a guarantee for payment of wages that were due to her. The claimant successfully issued proceedings for the annulment of the warrant, and the defendant appealed. The Court of Appeal, having agreed with the First Hall Civil Court's approach, also observed that it was a well-known principle that a director has to act for the benefits of the company and any contract in the name of the company with third parties does not bind the director personally. The Court also observed that in certain exceptional circumstances only a director has to be personally liable when they breach their fiduciary duty.

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<sup>524</sup> 22/01/1973 (Court of Appeal)

One further Maltese judgment that made reference to mandate law when interpreting the fiduciary duty of directors is *Advocate Doctor Ian Refalo noe et v Albert David Boweck et.*<sup>525</sup> The First Hall Civil Court, citing *Veglio v Camilleri*,<sup>526</sup> held that a director shall be considered as the mandatary of the company, implying, once again, that mandate law shall apply to the interpretation of the fiduciary duty of directors.

Another judgment that made reference to the law of mandate and to the previous case when interpreting the fiduciary duty of directors is *Advocate Doctor Anthony H Farrugia as a special mandatary of the minors Fabienne Carbone and Rowan Carbone v Vernie Carbone for and on behalf of various companies and Agostino sive Winston Carbone, together with Advocate Dr. Eric Mamo, for and on behalf of other companies*<sup>527</sup> In this case, filed before the First Hall Civil Court in 1990, the claimants asked the Court to declare various contracts null as he alleged the defendant Agostino sive Winston Carbone could not have appeared on these contracts on behalf of the various defendant companies as he had no right to do so. These contracts were taken out for loans and other bank facilities from the Mid-Med Bank Limited. The bank, which was also joined as a defendant, objected to the claimant's pleas and pointed out that even if Winston Carbone acted beyond his powers, such behaviour would not lead to the nullity of the contracts, but rather there would be a direct relationship between the shareholders and the company, even though the companies hold a separate legal person in their own right, which is distinct from that of its shareholders. The First Hall Civil Court accepted the Bank's argument, and the claimant appealed. The Court of Appeal went into the details of the defendant

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<sup>525</sup> 18/03/1983 (First Hall Civil Court)

<sup>526</sup> 22/01/1973 (Court of Appeal)

<sup>527</sup> 30/05/2001 (Court of Appeal) Cit. Nru. 82/1990/1

companies to illustrate that the First Hall Civil Court rightly reached its decision in accepting the Bank's reasoning. It found out that F&R Holdings Ltd was registered on 28<sup>th</sup> October, 1977. The two shareholders and directors were Inez Scicluna and Raymond Agius, but it transpired from the annual return dated 27<sup>th</sup> December 1977 that the shares were transferred to their minor children, who were the claimants. Winston Carbone was appointed director on the 26<sup>th</sup> May, 1978 instead of the other two directors and an amendment to the memorandum and articles of association of the company was made to reflect this change. Reference to Article 55 of the articles of the company was made which specified that any deed must be signed or executed by the managing director or by any other director or by any person delegated by the board of directors. Accordingly, the Court of Appeal noted that Winston Carbone had the right and duty to act on behalf of the company as its director and to sign contracts. With respect to the other defendant company, Everest Contractors Limited, the Court of Appeal noted that it was registered on 6<sup>th</sup> February, 1985 and Winston Carbone, together with his wife Vernie Carbone, were appointed as directors instead of the former directors on 10<sup>th</sup> September, 1985. Another defendant company was The Orangery Limited, which was registered on 30<sup>th</sup> September, 1983 and the claimants were the shareholders with the defendant Winston Carbone, being also the sole director. The Court of Appeal, therefore, noted that he had a right to represent these companies as well. The last defendant company was Overseas Trading Company Limited, later on known as Burlington Holdings Limited, and was registered on 31<sup>st</sup> May, 1972. The original shareholders were Walter and Mary Cassar, but their shares were later on transferred to F&R Holdings Ltd, above referred, and to Winston Carbone. Walter and Mary Cassar also resigned as directors and Winston Carbone was appointed in their stead.

In reaching its decision, the Court of Appeal made reference to the English legal system, which distinguishes between acts entered into which are beyond the objects clause of the company

and those other acts which are not beyond the objects clause but directors define this objects clause in general terms. In the first instance, the contract is always null, but in the second instance, the contract may be ratified by the company. The Court pointed out that one has to look at mandate law to fully understand the ratification process when the mandatary goes beyond the powers conferred. Again, the Court of Appeal made reference to the mandate provision as enacted in the Maltese Civil Code 1870 that a mandator is not bound by anything done by the mandatary beyond their powers, unless such act is expressly or tacitly ratified by the mandator. The Court, therefore, rejected the appeal and upheld the First Hall Civil Court's decision, as Winston Carbone was a director of all the defendant companies and had acted within the powers conferred upon him by the memorandum and articles of association of those companies.

Another judgment that applied the law of mandate because it was filed before 2003, and in which any reference to the English legal system would have been deemed inappropriate, was *Catherine, wife of Joseph Galea v Milica Micovic as a director of the company B. Tagliaferro & Sons Ltd.*<sup>528</sup> The claimant alleged that a promise of sale dated 25<sup>th</sup> February, 1991, which was later extended by a note dated 31<sup>st</sup> March, 1993, was signed between the claimant and the defendant. The defendant thus obliged itself to sell and transfer the temporary lease that still had to run on a property together with a third undivided share of the common parts of which the said property formed part, to the claimant. The claimant alleged that the defendant company had been reluctant to comply and the Court was asked for an order of specific performance. The defendant argued that the note for extension of the promise of sale was not signed by two directors of the company, as was required by the memorandum and articles of association. The

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<sup>528</sup> 19/11/2001 (Court of Appeal) Cit. Nru. 271/93/ GV

claimant tried to rebut this by citing the English doctrine of ostensible authority, which provides that if an outsider deals in good faith with the company, that individual has a right to enforce the contract irrespective of any limitations that may have been imposed on the director, and made reference to the English judgment *Freeman & Lockyer v Buckhurst Park Properties (Magal) Ltd.*<sup>529</sup> The First Hall Civil Court dismissed the claimant's argument on the basis that the claimant's father was the defendant company's auditor and he should have informed the claimant that the extension was not properly signed. Thus the promise of sale expired. In doing so, the Court cited *Hely-Hutchinson v Brayhead Ltd.*<sup>530</sup> and also repeated that if a third party knew or ought to have known of any limitations imposed on directors, then the contract would be null and cannot be enforced against the company.

This case was appealed, but the judgement was upheld by the Court of Appeal but this Court also specifically dismissed any reference to the English legal system made by the First Hall Civil Court and opted to only apply the law of mandate as enacted under the Maltese Civil Code 1870. As a result, the decision reached by the Court of Appeal was purely based on the Maltese law and Maltese *res judicata* judgments. The Court noted that the promise of sale was signed in 1991 and was extended in 1993, and any reference to the 1995 Act and its influences of the English legal system would have, consequently, been irrelevant. To fully demonstrate that only mandate law was to apply in this particular case, the Court also made reference to *Advocate Doctor Ian Refalo noe v Albert David Boveck* and Cremona and the argument that the directors are mandataries in their dealings with the company and are agents when they are dealing on behalf of the company with third parties. Accordingly, the Court of Appeal pointed

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<sup>529</sup> [1964] 2 QB 480

<sup>530</sup> [1967] 1 QB 549

out that any director had to act within the limits imposed upon them by the memorandum and articles of association of the company. Brief reference was made to the changes brought about by the 1995 Act, which states that any limitations on the powers of the board of directors cannot be relied on against third parties, if the third party would have acted in good faith with the company. However the Court of Appeal also pointed out that these changes were not in force at the material time and could not, therefore, be applied or referred to.

A further case that correctly applied the law of mandate was *Video-On-Line Limited v Ian Giles*.<sup>531</sup> In this case, the Court of Appeal only made reference to mandate law and did not mention any English judgments or make any references to the fiduciary character enjoyed by the directors. The claimant argued that the claimant company and another company, Global Services Limited, signed an agreement dated 22<sup>nd</sup> October 1999 which dealt with electronic infrastructure, but that payment was outstanding. The same agreement also indicated that the person responsible for the works for and on behalf of Global Services Limited was Ian Giles, the defendant. Giles, however, argued that he was not the legitimate party, but the company party to the agreement was the legitimate party. He also pointed out that the company party to the agreement and represented by him was never constituted in accordance with Maltese law. The Court of Magistrates in its civil jurisdiction felt that it did not need to delve much into the circumstances and readily accepted the defendant's argument on the basis that the agreement was between two companies and Ian Giles was not the legitimate party. The claimant appealed and on appeal, it was held that since the company was not constituted in accordance with Maltese law, Giles personally should be bound by the agreement and not the company. The Court remarked that it was indisputable that a director of a company is considered as the

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<sup>531</sup> 25/02/2004 (Court of Appeal) Cit. Nru. 339/2002/1

mandatary of that company with respect to the interactions with the company itself while a director is considered to be the representative of the company with regards to the third party dealings, again making reference to *Advocate Doctor Anthony H Farrugia as a special mandatary of the minors Fabienne Carbone and Rowan Carbone v Vernie Carbone for and on behalf of various companies and Agostino sive Winston Carbone, together with Advocate Dr. Eric Mamo, for and on behalf of other companies*. It also pointed out that these company law principles can only apply when the company is legally constituted. It, therefore, overturned the first decision and allowed the claimant's appeal, with the result that the defendant was found personally liable for the execution of the contract.

Another Maltese judgment that correctly applied the law of the time was *Francis Busuttil and Sons Limited v Christopher Apap and Reflex Computer Systems (Malta) Limited*.<sup>532</sup> In this case, The Court of Appeal resorted to the statute law when the action was filed and not when the action was adjudicated. The Court made reference to mandate law and applied the fiduciary duty of directors within the limits of interpretation of such mandate law. The claimant company filed the action on 14<sup>th</sup> February 1997, and alleged that the defendants had to install computer software on the premises of the claimant company, but the defendants did not abide by the contract, failed to carry out the works within the specified time limits and also carried out defective work, resulting in damage. The defendants argued that the claimant company was in fact making use of the software installed, and more time was needed than agreed because the claimant company was always changing the required specifications. The defendant company also claimed that the defendant, Christopher Apap, should be personally responsible for the works and not the company itself. The First Hall Civil Court decided that Apap was not the

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<sup>532</sup> 30/05/2014 (Court of Appeal) Cit. Nru 331/1997/1

legitimate party to this action and only found the defendant company in breach of the contract. The claimant appealed because Apap was not found personally liable for the execution of the contract, together with the defendant company. The Court of Appeal held that any company, as a mandator, needs to expressly or tacitly accept and ratify the operations of its directors who act as its mandatary for such operations to be fully complied by the company when the directors act beyond the powers conferred to them. However, in this case, the Court was convinced that the defendant company expressly showed that it had ratified Apap's actions who was acting as the defendant company's director. Accordingly, the Court also came to the conclusion that the defendant company was fully responsible for the damages suffered by the claimant, and Apap could not be held personally liable for any damages suffered by the claimant company. In reaching its decision to award damages to the claimant company, the Court of Appeal agreed with the First Hall Civil Court's observations, and pointed out that the works undertaken by the defendant company were not up to standard and had many defects.

The applicability of mandate law within the limits of the English influences, as introduced in the 1995 Maltese Act, was again correctly resorted to in *Deirdre and John Cachia v Gaba Diamonds Company Limited*.<sup>533</sup> The claimants filed the action on 29<sup>th</sup> October, 1998, in which they alleged that they entered into a private agreement dated 17<sup>th</sup> June, 1996 with the defendant company. The defendant company was given under a title of lease premises and a garage. The claimants alleged that the defendant terminated the lease without notice, which resulted in loss suffered by the claimants. The defendant company tried to rebut the claim and responded that Cremona, as one of the two directors of the defendant company, did not have power to solely sign the private agreement in question, which had to be signed by both directors, as clearly

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<sup>533</sup> 28/11/2003 (Court of Appeal) Cit. Nru 2227/1998/1

provided for by the memorandum and articles of association. The defendant also argued that it had every right to terminate immediately this lease agreement as and when desired. The First Hall Civil Court, although it did not make any specific reference to the law of mandate, applied the principle of ratification for when an action is not correctly entered into by the directors of the company in accordance with its memorandum and articles of association. The Court, therefore, said that when directors act beyond the powers conferred upon them, the company must ratify those acts to be bound by it as the directors would otherwise be liable for those acts. As a result, the Court rejected the claim on the basis that the lease was not signed by both directors as required by the memorandum and articles of association. The Court also made reference to Article 1233 of the Maltese Civil Code 1870 to substantiate its argument, which states that any lease entered into for a period of more than two years shall be signed by all the involved parties to be considered a valid agreement. This lease agreement was, therefore, invalid. The claimants appealed and on appeal, the Court of Appeal, overturned the earlier decision and held that, although it is an established principle that the memorandum and articles of association is public and can be easily accessible by third parties, the law also provides for the principle that when a third party is morally and legally convinced that the act entered into is not against the company's powers, any technical impediment by the directors must not lead to prejudice against the third party. The Court pointed out that a director, as a mandatary of the company, had an obligation to act within the limits of the mandate given. However, the Court also said that the third party protection, as influenced by the English legal system, introduced by the 1995 Act had to be applied in this case since this was an action filed after that time. The Court pointed out that a third party does not have the duty to ask for any mandate that is signed between the company and its directors, making reference to the English judgment *Royal British*

*Bank v Turquand*<sup>534</sup> and to the Maltese judgment in *Borg v Camilleri*,<sup>535</sup> which itself made reference to the *Turquand* principle. The Court of Appeal, consequently, accepted the claimants' claim for damages and found the defendant company liable.

### ***5.3.1.2 Applicability of the English legal system when an uncertainty is present***

Although the law of mandate should have been applied in its entirety, the Maltese Courts felt, in one particular instance, to observe that the Maltese legal system may resort to the English legal system whenever a particular circumstance is not covered by Maltese law presents itself and the law of mandate cannot, accordingly, be adequately applied to interpret the fiduciary duty of directors.

This approach was applied in *Giovanni Anastasi noe v Kaptan Serafino Xuereb M.B.E and Construction Limited*,<sup>536</sup> in which the Maltese Commercial Court declared that the directors should be considered as mandataries. The claimant alleged that he entered into a contract with the defendant company, Construction Limited, for the manufacture and sale of furniture by a contract dated 23<sup>rd</sup> April 1950. Construction Limited was composed of Strickland and Xuereb, who were appointed as directors, together with the claimant also appointed as director. The claimant was also the director of Malta Industrial Arts Limited. The defendants unilaterally decided on 14<sup>th</sup> May 1951, to close the factory but the claimant was not present to this Board meeting. The claimant was informed of the meeting just few hours before it was due to start, but he could not attend and was not informed of the agenda. Due to the decision taken by the

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<sup>534</sup> This judgment was cited in 'Protection of outsiders' in the publication of Charlesworth and Cain, Company Law (12<sup>th</sup> edn. Sweet & Maxwell 1983)

<sup>535</sup> 07/04/1997 (First Hall Civil Court)

<sup>536</sup> 14/6/1951 (Third Part)

other two directors, the claimant alleged that he could not exercise his rights as a director and, therefore, asked the Commercial Court to declare the decision taken by the defendants as null. The Commercial Court pointed out that the Maltese law was still very much weak in the field of company law, and reference to the English legal system seems appropriate in such circumstance. In this regard, the presiding judge observed that companies being formed in Malta were modelled on the United Kingdom's Companies Act 1948, and in cases of uncertainties, reference to the English legal system was therefore appropriate. Since in this particular case the presiding judge observed that the articles of association of the company were not formulated, reference to the English legal system had to be made, especially with respect to the regulation of the management of the company. Accordingly, the Commercial Court drew a distinction between a general meeting and a board of directors' meeting, and declared that the agenda shall be given in full detail only with respect to a general meeting, as also provided for by the English and Italian legal systems. This was an action challenging a decision taken by the board of directors in which the English legal system does not provide that a detailed agenda shall be provided for such meetings, unless the articles of association do not indicate otherwise. The Maltese Commercial Court however also felt it appropriate to make reference to mandate law and said that the directors of the company shall be considered mandataries. Nevertheless, the Commercial Court did not take a final decision as it was of the opinion that it was up to the shareholders to decide what should happen of the company, and not the Courts.

### ***5.3.1.3 Applicability of Article 136 A of the Maltese Companies Act 1995, together with the law of mandate***

For cases filed before 2003, the Maltese Courts should have applied the law of mandate and any other provision that was specifically enacted in the Commercial Ordinances or Acts.

Accordingly, any reference to Article 136 A of the Companies Act 1995 and its ancillary fiduciary provisions should be considered irrelevant because the 2003 and 2004 provisions were not in force at the time of the filing and a person can only be judged on the law at the time of the filing of the case and not afterwards. If after the filing of the action, the breach starts to be considered as legal or more penalties are added it should not affect the outcome.

The Maltese Courts have, however, sometimes confused the correct application of the Maltese law, by having intertwined the mandate law and other specific provisions as enacted in the Ordinances and Acts with Article 136 A of the Companies Act 1995, as can be seen in *Emanuel Chircop v Carmel sive Charles Busuttil*.<sup>537</sup> In this judgment, the Maltese Courts misapplied the law when referring to the fiduciary duty of directors because, although this particular case was filed before 2003, it was ultimately decided under Article 136 A of the Companies Act 1995. This particular action became *res judicata* in 2013, but the Maltese Courts should have only made reference to the applicable law that was in force when it was filed. The case concerned the company Continental Postform Limited, which was registered as a limited liability company on 28<sup>th</sup> January 1992 and which stopped operating in 1997 to be eventually liquidated in 1999. The action was filed by the claimant in 1997 lamenting the maladministration that took place in the company by the defendant, Carmel sive Charles Busuttil, before 1997. Chircop claimed that the company was equally held and administered by the claimant and defendant, in that they were equal shareholders and that they were also the sole directors. Although they were both vested with the administration of the company, as required by the memorandum and articles of association of the company, the claimant stated that only the defendant took care of the financial position of the company. The claimant suspected that the

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<sup>537</sup> 12/11/2013 (First Hall Civil Court) Cit. Nru. 1223/1997/1

financial position of the company was not as good as it should have been, and he therefore appointed auditors to check for any cash discrepancies, which ultimately confirmed his suspicions. Chircop asked the Court to hold the defendant liable for any loss that was suffered by the company. The defendant refuted the claim asserting that the cash variances amounted to remuneration owed to the defendant for the work done by him for the company. The defendant also pointed out that the money was put in envelopes and handed over to the secretary and that the cheques were signed by both directors. The First Hall Civil Court pointed out that the cash variances that occurred between 1987 and 1991 could not be taken into consideration since the company was formed in 1992. It also appointed an expert, Kevin Mahoney, to help it better understand the management of the company. Mahoney drew up two reports, but could not come to a conclusion since he said that he did not have enough documentation to which he could refer, even though attempts had been made to compile as much evidence as possible. He also referred to a report by Tony Cassar and Anthony Darmanin, who were jointly appointed by the claimant and the defendant to attempt to come to a reasonable conclusion on the management and financial position of the company. Cassar and Darmanin reported that the turnover was underreported, thus leading to the conclusion that mismanagement had taken place. While the Court acknowledged that there were cash discrepancies, it found that the claimant failed to bring clear evidence that the defendant was taking the company's money for his own personal benefit. The Court further pointed out that the fact that the defendant bought several properties in a limited amount of time was not a sufficient proof that he took money from the company as he also had other business interests. Consequently, the First Hall Civil Court rejected the claim. However, what is even more interesting is to evaluate on what reasons the Court reached its decision. In fact, in this regard, it is important to understand what law was applied by the First Hall Civil Court in this particular case. In reaching its decision, the Court acknowledged that the claimant's action was filed in accordance with Article 136 A of the Companies Act

1995, which requires that a director shall act with honesty and in good faith in the best interest of the company. The Court nonetheless also said that a director shall be considered a mandatary of that particular company that they manage which creates a fiduciary relationship with that company. Regrettably, therefore, one problem that had arisen was that although the company was formed in 1992 and the cash variances had occurred from 1987 until 1997, reference to the new Article as enacted in 2003 was also made, rather than the law of mandate and any other provision that was in force before 1997.

The same misinterpretation was again reached in *Advocate Doctor Victor Emanuel Ragonesi v Albert Stagno Navarro and Architect Frank Giormaina Medici in their own name and also as directors of Heritage Estates Limited*;<sup>538</sup> in which judgment the Maltese Court of Appeal also made reference to Article 136 A of the Maltese Companies Act 1995, even though this case was filed before 2003. The claimant filed an action with respect to a promise of sale dated 10<sup>th</sup> March, 2000, which was signed by the defendant Albert Stagno Navarra in the name of the company, Heritage Estates Limited, and by the claimant for the sale of property. The claimant paid the whole amount to the defendant on the promise of sale, but one of the conditions in the promise was that the defendant would have to repay the whole amount back to the claimant if the promise of sale did not solidify into a contract of sale due to any issue impugned to the defendant. In fact, it transpired that the promise of sale could not be materialised because the defendant had already sold the same property to someone else. The First Hall Civil Court gave judgement on 14<sup>th</sup> November 2005, and ordered the defendants to repay the claimant the amount for the property. The defendants appealed. The Court made reference to Article 136 A (1) of the Companies Act 1995, which states that directors have a duty to act with loyalty and

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<sup>538</sup> 09/01/2009 (Court of Appeal) Cit. Nru. 771/2001/3

in the best interest of the company. However, although the First Hall Civil Court and also the Court of Appeal were of the opinion that the claimant has suffered damages, the Court of Appeal overturned the earlier decision because it was of the opinion that a third party has to first ask the Court for the company to be struck off to thereafter be in a position to receive damages when the third party alleges bad faith on the part of the directors for and on behalf of the company. The Court pointed out that the claimant had not asked for the striking off of the company, and so could not be awarded damages.

### **5.3.2 Case law filed post-2003**

#### ***5.3.2.1 Applicability of Article 136 A of the Maltese Companies Act 1995 only***

For cases filed after the coming into force of Article 136 A of the Maltese Companies Act in 2003, reference to mandate law should have been abolished and most Maltese judges and magistrates correctly decided to limit their interpretation of the fiduciary duty of directors to Article 136 A.

One of the first judgments that suitably applied the law was *Oreste Cilia pro et noe v Daniel Cilia pro et noe et.*<sup>539</sup> In this case, the claimant filed the action on 1<sup>st</sup> October, 2004; the details of the case are given in Section 4.4.1. The First Hall Civil Court declared that a director has to abide by the duty to act in good faith and in the best interest of the company, as listed under Article 136 A of the 2003 Act.

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<sup>539</sup> 08/01/2015 (First Hall Civil Court) Cit. Nru. 735/2004

Another judgment which correctly applied the law is *Advocate Doctor Jean C Farrugia noe v Aqua Oasis Limited (C 41157) and Dorte Rickert as the shareholder and director of the company*,<sup>540</sup> the details of which can be found in Section 4.4. The First Hall Civil Court reached the conclusion that the defendant failed to abide by her duties under Article 136 A Companies Act 1995 and was found liable for the damages suffered by the defendant company.

The correct application of the law was again applied in the Maltese judgment *Architect Mariello Spiteri v Registry of Companies et*<sup>541</sup> (vide Section 4.4.2). Reference to Article 136 A of the Maltese Companies Act 1995 was made by the First Hall Civil Court, which held that every director is responsible for the general governance of the company, and so every director of every company was bound by this fiduciary duty without any exceptions. As a result, the Court accepted the Registry of Companies' argument and found the claimant liable.

Specific reference to Article 136 A of the Maltese Companies Act 1995 was again made by the Court of Appeal in *Architect Raymond Vassallo pro et noe et v Anthony Parlato Trigona et*<sup>542</sup> (vide Section 4.4.1) where the Court of Appeal held that the defendants, as directors, must act in good faith and the best interest of the company in accordance with Article 136 A. The Court of Appeal decided that the defendants made secret and personal profits from their position of directors without having sought the prior approval of the company. However, the defendants were then acquitted on the basis that the claimants had not filed the action properly.

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<sup>540</sup> 16/10/2015 (First Hall Civil Court) Cit. Nru. 651/2008

<sup>541</sup> 15/01/2015 (First Hall Civil Court) Cit. Nru. 778/2008

<sup>542</sup> 30/09/2016 (Court of Appeal) Cit. Nru. 716/2011/1

Just one month later, the First Hall Civil Court, again, made reference to Article 136 A of the Companies Act 1995 to interpret the fiduciary duty of directors in the judgment *Mark Hogg noe v Terra Sana Ltd et*<sup>543</sup> (vide Section 4.4.5). The First Hall Civil Court held that the directors were in breach of their fiduciary duty imposed under Article 136 A of the Companies Act 1995 because the Court reached the conclusion that the claimant was not provided with all the information that the defendants had and also that whenever the directors' interests were to conflict with those of the company, they were bound to seek prior approval in the general meeting or they had to ensure that their conflict of interest was approved as per the memorandum and articles of association.

### ***5.3.2.2 Applicability of Article 136 A of the Maltese Companies Act 1995 and the fiduciary provisions of the Maltese Civil Code 1870***

Articles 1124 A and B of the Maltese Civil Code 1870 are used when the person in question does not hold the exclusive title of a director, and thus Article 136 A of the Maltese Companies Act 2003 cannot apply. The Maltese Courts have rightly applied these provisions as will be analysed below.

The correct application of the law was made by the Maltese Courts in *Amadeo Balzan v Central Holidays (Travel and Tourism Ltd) and Alexandra Balzan Ruggier et*<sup>544</sup> (vide Section 4.5) In this case, reference only to Article 136 A of the Companies Act 1995 was made by the First

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<sup>543</sup> 31/10/2016 (First Hall Civil Court) Cit. Nru. 607/2013

<sup>544</sup> 16/06/2015 (First Hall Civil Court) Cit. Nru. 581/2011

Hall Civil Court because it was an action filed after 2003 by a director of the company against another director of the same company. This claimant filed this action on 17<sup>th</sup> June 2011. The claimant based his case on Article 136 A of the Companies Act 1995 and on Articles 1124 A and B of the Maltese Civil Code 1870. However, the First Hall Civil Court felt it necessary to draw a distinction between the statutory provision as enacted in the Companies Act 1995 and the statutory provisions as enacted in the Civil Code 1870. In this regard, the Court pointed out that article 136 A of the Companies Act 1995 shall be considered as the *lex specialis* which can only be invoked by a director against another director of the company whereas articles 1124 A and B of the Maltese Civil Code 1870 are referred to as the *lex generalis* and can only be applied when article 136 A cannot hold ground. In this regard, the Court reached the conclusion that the claimant's claim cannot hold because he was not a director during the course of action.

The new provisions of the Civil Code 1870 were, however, correctly applied in *Anthony Caruana and Sons Limited et v Christopher Caruana*<sup>545</sup> since the defendant was employed as a general manager and did not expressly hold the title of a director (vide Section 4.5). The Court, therefore, felt compelled to make reference to Article 1124 A of the Civil Code 1870 when passing judgement on the issues of confidentiality and the duty to act in the best interest of their appointer. The Court also referred to the English judgment *University of Nottingham v Fishel*<sup>546</sup>, incorrectly noting that the fiduciary obligations concept had been introduced into the Maltese legal system due to the English influences. This English judgment, nevertheless, concluded that an employment relationship is not fiduciary, and the fiduciary duty shall

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<sup>545</sup> 28/02/2014 (Court of Appeal) Cit Nru. 573/2005/1

<sup>546</sup> [2000] EWHC 221 (QB) (19 January 2000)

therefore not apply to the employee. Reference was also made to the English judgment *Korbond Industries Ltd v Jenkins*,<sup>547</sup> in which the Court decided that a distinction must be drawn between a person who is a decision maker and a person who only holds a senior position. Reference to old Maltese judgments<sup>548</sup> that also assert that an employee may compete with the employer after terminating his contract was also made. As a result, the claimant's action was deemed unsuccessful. Nonetheless, the claim was successful on appeal, whereby the Court of Appeal made specific reference to various legal scholars<sup>549</sup> and a Maltese judgment<sup>550</sup> and concluded that Articles 1124 A and B of the Maltese Civil Code 1870 did not introduce a new concept into the Maltese legal system, but rather clarified the previous situation as regulated by Roman Law of what this fiduciary entails and who shall be bound by it, in view of which the Court of Appeal decided that the defendant was bound by the fiduciary duty due to his position of general manager as any other director and was, therefore, liable for damages suffered by the claimant.

### ***5.3.2.3 Applicability of mandate law together with Article 136 A of the Maltese Companies Act 1995 and the fiduciary provisions of the Civil Code 1870***

For case law filed after the coming into force of Article 136 A in the Companies Act 1995 and Articles 1124 A and B of the Maltese Civil Code 1870, reference to mandate law should not have been made by the Maltese Courts, since it had been replaced by these Articles. Yet, the Maltese Courts have, on occasion, continued to refer to it. This is surprising since the fiduciary

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<sup>547</sup> [1992] 1 ERNZ 1141 (EMC) at 1150

<sup>548</sup> Vide *Attilio Vassallo Cesareo et noe vs Tony Cilia Pisani* (First Hall Civil Court – 31/01/2003) and *Charles Attard v Carmela Frendo* (First Hall Civil Court – 31/01/2003)

<sup>549</sup> Vide Lee, *The Elements of Roman Law*, (n 115) pp. 340

<sup>550</sup> *Cordina v Cordina* (Court of Magistrates (Gozo) (Superior Jurisdiction) – 26/09/2007)

duty of directors is interpreted differently under the law of mandate and under Article 136 A of the Companies Act 1995, as we saw in Chapter 4.

One judgment that referred to mandate law even though the action was filed after the coming into force of Article 136 A of the Maltese Companies Act 1995 was *Enemalta Corporation v Vella Group Limited and John Mary Vella*.<sup>551</sup> The claimant filed this action for damages that were suffered when the defendants were carrying out road works and cut the electricity supply. The claimant company asserted that the damage was caused due to the negligence of the defendants, and that there was not even any prior consultation between the parties involved to fully understand where the electricity wires were laid. The defendant company pleaded that the action was time barred under Maltese law, and should this plea not subsist, it still cannot be held liable for the damage as it had done nothing wrong. The other defendant, John Mary sive Jimmy Vella, argued that he could not be held personally liable for the damages since these works were undertaken by the company in its own name. The Small Claims Tribunal cited Article 136 A of the Maltese Companies Act 1995 and decided that if a director acted beyond the powers provided to him by the memorandum and articles of association of the company, that director shall be held personally liable for any damage that may be incurred. It concluded that Jimmy Vella, as a director, had to personally answer for the damage caused to the claimant company because he had acted beyond the powers given to him by the company since he acted before the permits were issued and did not act in good faith in the best interest of the company. Jimmy Vella appealed the Tribunal's decision and said that Article 136 A of the Maltese Companies Act 1995 should only apply with regards to relationships between the director and the company, and not between the director as representing the company and a third party. He

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<sup>551</sup> 08/06/2006 (Court of Appeal) Cit Nru. 1837/2004/1

argued that he only undertook the works and gave the necessary instructions as a mandatary of the company. The Court of Appeal upheld the Tribunal's decision and found him personally liable for the damages suffered by the claimant company. Regrettably, the Court did not specifically exclude the reference made by the defendant to mandate law. Accordingly, the Court of Appeal seems to have accepted the concurrent reference to mandate law and Article 136 A of the Maltese Companies Act 1995.

In another instance, an undesirable result was also reached whereby albeit mention to Article 136 A of the Companies Act 1995 was not made, reference to both the fiduciary provisions of the Maltese Civil Code 1870 and mandate law was made. This judgment is *Vascas Enterprises Limited v Adrian Ellul*<sup>552</sup> (vide Section 4.5). In this case, the First Hall Civil Court established that the directors of a company shall be considered as the mandataries of the company and their duties governed by Article 1124 A of the Maltese Civil Code 1870, if that individual is not explicitly appointed as a director. The Court thus linked the fiduciary statute law provisions and mandate law together, and applied them interchangeably. The reason for linking these two statutory provisions was probably because Article 1124 A did not introduce a new concept into statute law, but rather clarified what the position had always been. Nevertheless, a fiduciary and a mandatary have different duties, as we saw in Chapters 2 and 4, with the consequence that the Court's approach was erroneous in this case.

The application of Article 136 A of the Maltese Companies Act 1995, together with the law of mandate was again found in *Jane Chircop et v Robert Mizzi pro et noe et*<sup>553</sup> (vide Section 4.4.1)

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<sup>552</sup> 13/11/2014 (First Hall Civil Court) Cit. Nru 111/2011

<sup>553</sup> 27/04/2017 (First Hall Civil Court) Cit. Nru. 459/14

In its judgement, the Court made reference to the notion that the company is the mandator and the directors are, therefore, its mandataries. It also made reference to Article 136 A of the Companies Act 1995 which states that directors are duty bound to act in good faith and in the best interest of the company.

#### ***5.3.2.4 Applicability of mandate law only***

In other instances, the Maltese Courts have completely misinterpreted the fiduciary duty of directors since 2003 by having applied only the law of mandate, as can be evidently seen in *Sirap Limited v IT 2010 Limited et.*<sup>554</sup> This case was not filed by a director against another director of the same company, but reference to mandate law in the context of the fiduciary duty of directors was still made. The claimant company filed an action on 3<sup>rd</sup> June 2010, alleging that the claimant company requested the defendant company, among others, to pay a sum of money for goods sold to the defendant company. The Court made reference to the claimant's observation that the directors are considered mandataries in their relationships with the company and as agents when representing the company with third parties, and also made reference to *Advocate Doctor Anthony H Farrugia as a special mandatary of the minors Fabienne Carbone and Rowan Carbone v Vernie Carbone for and on behalf of various companies and Agostino sive Winston Carbone, together with Advocate Dr. Eric Mamo, for and on behalf of other companies*,<sup>555</sup> (vide Section 4.3.6) a judgment that was decided before 2003. The Court of Magistrates should have pointed out that any observation made in terms of mandate law with respect to the interpretation of the fiduciary duty of directors shall be disregarded in any action filed after 2003 due to the enactment and coming into force of Article

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<sup>554</sup> 7/10/2013 (Court of Magistrates) Cit. Nru. 206/2010

<sup>555</sup> 30/05/2001 (Court of Appeal) Cit. Nru. 82/1990/1

136 A in the Maltese Companies Act 1995. Ultimately, the Court found the defendant company liable for the damages, but did not find the director of the defendant company liable since it believed that the director shall be held personally liable only when the company is in liquidation.

The same erroneous interpretation with respect to the applicable law to the fiduciary duty of directors was also applied in *SRAM Limited v Geomike Limited et.*<sup>556</sup> As with the previous judgment, this case was not filed by a director against another director of the same company, but reference to mandate law in the context of the fiduciary duty of directors was still made. The claimant company filed an action against the defendant company and its director on 3<sup>rd</sup> May 2011 for damage suffered by poor building work. The defendant company asserted that it should not be held responsible for anything as it had never entered into any agreement with the claimant company. To understand whether the company alone or the other defendant should be held liable, the Court made reference to mandate law when referring to the fiduciary duty of directors. It held that directors shall be considered agents or mandataries of the company, and that the company enjoys a separate legal personality from its shareholders. Drawing on precedent and academic writing,<sup>557</sup> it stated that:

‘according to law, directors, in their dealings with the company are the mandataries of, and in their internal dealings with third parties are the agents of the company. In the former case the general principles of the law of mandate and in the latter case those of the law of agency would apply’.

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<sup>556</sup> 18/11/2013 (Court of Magistrates) Cit. Nru 146/2011

<sup>557</sup> The courts cited F. Cremona, *The Law on Commercial Partnerships in Malta*, pp. 108, *Advocate Doctor Ian Refalo noe v. David Boweck et*, decided by the First Hall Civil Court on the 18<sup>th</sup> March, 1983 and *Catherine Galea v. Milica Micovic noe*, Cit. Nru.271/93 decided by the First Hall Civil Court on 13<sup>th</sup> November 1995 and confirmed on appeal on 19<sup>th</sup> November, 2001. All of these judgments were analysed above

The Court, therefore, held that the defendant, John Cauchi, shall not be held liable for the claimant's actions, but the defendant company was found liable for the damages suffered by the claimant company as John Cauchi was acting for and on behalf of the company.

The same inappropriate reasoning based on mandate law was once more reached in the Maltese judgment *Central Holidays (Travel Agents and Organisers) Limited v Alexandra Balzan Ruggier et*<sup>558</sup> (vide Section 4.5). Reference to the law of mandate was, therefore, again applied with respect to the fiduciary duty of directors. The case concerned non-payment of an earlier debt and recovery of the value, but the key issue here is that Alexandra Balzan Ruggier, contended that the premises in question were given under lease to her and Amadeo Balzan, as directors of the company Central Travel Holidays & Tourism Ltd, to use as a travel agency. This lease was signed by Amadeo Balzan on behalf of the company of which he was . Amadeo Balzan was a director until 20<sup>th</sup> October, 2008. The same lease continued to appertain to both of them, even after the premises were transferred to another company. The First Hall Civil Court concluded that, since Amadeo Balzan was a director of the company in April 2008, he could enter into a lease agreement for and on behalf of the company with the claimant company. The Court pointed out that it is an indisputable principle that a director is considered a mandatary of the company with respect to his relationships with the company, whereas he is considered as the representative of that company for the relationships between the company and third parties.<sup>559</sup> Consequently, the First Hall Civil Court once again decided that the defendants, as directors of the companies in question, were liable for the damages suffered by the claimant and have to pay accordingly.

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<sup>558</sup> 23/3/2015 (First Hall Civil Court) Cit. Nru 116/2011

<sup>559</sup> The Court cited *Farrugia v Carbone* in this respect (30/03/2001), which was analysed above

## 5.4 Conclusion

Over the past century, only 25 judgments have been handed down by the Maltese Courts that I am aware of that specifically deal with the interpretation and application of the fiduciary duty of directors. As can be seen from these *res judicata* judgments, some judges and magistrates have correctly applied the law, but others have, unfortunately, misapplied it. Some persons of the judiciary applied Article 136 A of the Maltese Companies Act 1995 even to actions filed before the coming into force of the Article, while others applied mandate law for actions filed after the coming into force of Article 136 A of the Maltese Companies Act 1995.

## **Chapter 6. Conclusion**

This dissertation has examined the fiduciary duty of company directors under the Maltese legal system as an example of legal transplantation as presented under statute law and by the judiciary from the 19<sup>th</sup> century until the present date. It culminated in a description of the detailed factors that have hindered the full effectiveness of legal transplantation in the Maltese context, as seen through the regulation of the fiduciary duty of directors. Chapter 1 presented several factors that have affected the smooth legal transplantation process in the Maltese context, both from a statutory perspective and also with respect to the Maltese judiciary. These factors included the historical, cultural, societal, prestige, economic and political factors, together with familiarity with the law, and the courts' influence.

These factors have led the Maltese statutory process to be influenced by the Italian and English legal systems. They led to the application of mandate law, as influenced by the Italian legal system, to be the first law to regulate the fiduciary duty of directors, but from the 1940s, the British influence grew in the Maltese legal system, with the result that until 2003, the Italian and English legal systems were concurrently applied. It also argued that since 2003, the English legal system was solely relied on by legislators to regulate the fiduciary duty of directors. The study also suggested that these factors have led to literal borrowing from the Italian legal system, but less so from the English legal system. There was also the enactment of two other provisions in which the Maltese legislators' invention should be considered unique since Roman law was solely resorted to ensuring that any fiduciary relationship between two persons, irrespective of their title, is thoroughly regulated.

This thesis has also presented the notion that these factors have led the majority of the Maltese judiciary to depart from the statutory approach over time and to create their own unique interpretation of the applicable statute law. It observed that there was no smooth transition in the application of statute law by the majority of the Maltese judiciary. In fact, this study demonstrated that there were cases filed before 2003, but because the judgment was delivered after 2003, the presiding judge felt the need to make reference to the law as it was before 2003. However, there were other judges and magistrates who felt the desire to make reference to mandate law for an action filed after 2003. It was also shown that certain other judges and magistrates opined that the English influences had started to grow before the appointment of the 1954 Maltese Commission, which provided the basis for the enactment of the 1962 Maltese Commercial Ordinance.

Consequently, this dissertation has advanced important technical comparisons through Maltese statute law and judicial practice to assess whether legal transplantation in the Maltese context can be deemed to have successfully taken place or not. Therefore, by using a comparative legal analysis, this study has examined the effectiveness of legal transplantation with respect to the regulation and interpretation of the fiduciary duty of directors in the Maltese statutory and judicial legal system.

In view of this, I can conclude that the thesis presents two observations. First, the factors presented under the legal transplant concept have led the Maltese statute law to not always be the result of literal borrowing from the two foreign legal systems, since different interpretation of the statutory provisions arose under each of the three legal systems (vide Chapter 4); thus leading to the conclusion that legal transplantation has only taken place limitedly by the factors

presented under Chapter 1. Second, the majority of the Maltese judiciary, especially from the 1940s onwards, have not always interpreted the law in line with the statutory developments since most of the judiciary were interested in other factors than those factors that the Maltese legislators were interested in (vide Chapters 3 and 5); thus leading to judicial nihilism (vide Chapter 1).

## **6.1 Key findings**

At first glance, it might seem that the factors presented above have led the legal transplantation process to be fully adequate and applicable under the Maltese legal system, in which literal borrowing from the Italian and English legal systems might seem to have been nicely reproduced in the Maltese legal system. However, when one looks more closely at each of the three legal systems, divergences arise that ultimately prove that a legal rule is uniquely influenced by the factors mentioned above, which can be categorised among others, as the historical, societal, economic and political factors. I can, accordingly, conclude that the factors mentioned in Chapter 1 and discussed throughout this thesis have clearly influenced the application of the legal transplantation theory in the Maltese context.

Four main findings can be observed. First, a substantial difference in the method of borrowing by the Maltese legal system can be observed when influenced by the Italian and English legal systems. Whereas literal borrowing can be seen when the Maltese statutory provisions of the mandate law were influenced by the Italian legal system, substantial changes to Article 136 A of the Maltese Companies Act 1995 were carried out when this provision was influenced by the English legal system. Accordingly, a partial and selective approach was applied by the Maltese legislators to the English influences as opposed to the Italian influences. Second, it is

seen that the fiduciary provisions in Articles 1124 A and B of the Maltese Civil Code 1870 enacted in 2004 were not influenced by the Italian or English legal systems, but were entirely an idea of the Maltese legislators to ensure that any fiduciary relationship between persons is regulated. These provisions were influenced by Roman law and their introduction into the Maltese legal system clearly shows the country's historical ties to the civil legal system, which have remained very strong. Such a unique Maltese approach was discussed in *Anthony Caruana and Sons Limited et v Christopher Caruana*<sup>560</sup> (vide Chapters 4 and 5), when the Court of Appeal made specific reference to various Maltese judgments and legal scholars to determine that Articles 1124 A and B of the Maltese Civil Code 1870 did not introduce a new concept into the Maltese legal system, but rather clarified the situation that has always applied under the Maltese legal system. Third, this study showed that the Court's influence has led to its own conclusions, which have not always coincided with the path taken by the statutory developments, as influenced by the two foreign bodies, namely the Italian and English legal systems. Fourth, a brief examination shall be presented to demonstrate whether legal transplantation is observed under other areas of Maltese statute law as well and a discussion is presented to understand whether this transplantation process varies whether a civil or a common legal system is resorted to.

### **6.1.1 Borrowing from the Italian and English legal systems**

With respect to the first deduction, and thus to the pattern observed under the Maltese legal system, a substantial difference between the influences exerted by the Italian and English legal systems is observed.

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<sup>560</sup> 28/02/2014 (Court of Appeal) Cit Nru. 573/2005/1

Literal borrowing, or borrowing-transposition, is observed from the Italian legal system with the enactment of the mandate provisions under the Maltese Civil Code 1870. Certain legal scholars refer to this type of borrowing as legal translation wherein ‘the translator’s task is to reconstruct the form and substance of the source text as closely as possible’.<sup>561</sup> Such exact borrowing could have taken place due to three reasons. First, as was already pointed out in Chapter 3 of this thesis, Maltese legislators realised that the mandate provisions were perfectly working under the Italian legal system to regulate the fiduciary duty of directors and there was, thus, no need for any particular change. Second, such literal borrowing was possible because Maltese legislators at the time of the enactment of the mandate provisions under the Maltese Civil Code 1870 were very much interested in the historical, societal and cultural ties that the Maltese legal system enjoyed to the Italian legal system, together with the Maltese familiarity with the Italian legal system, as demonstrated in Chapter 3 of this thesis. Accordingly, such legal borrowing resulted in the similarities exhibited between the Italian legal system, as the donor, and the Maltese legal system, as the recipient.<sup>562</sup> Third, apart from the detailed differences outlined above, there might also be a more generic reason that can explain the differences between the type of adaptations when the Italian and English legal systems were resorted to. This third reason presents the notion that these discrepancies in the type of borrowing cannot only be attributed to the diverse country of origin with different economic backgrounds and different times when the provisions under the Maltese and English legal systems were enacted. In fact, this might be because the mandate law is looked upon as a

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<sup>561</sup> Susan Sarcevic, ‘Legal Translation and Translation Theory: a Receiver-oriented Approach’, University of Rijeka, Croatia <<http://www.tradulex.com/Actes2000/sarcevic.pdf>> accessed 20 September 2018 and Layachi Aissi, ‘An Analytical Study of the Process of Translation’, A Thesis Submitted To The University of Salford Faculty of Arts Department of Modern Languages in fulfillment of the requirements for the degree of Doctor of Philosophy 1987 <<http://usir.salford.ac.uk/14673/1/DX184754.pdf>> accessed 10 July 2018

<sup>562</sup> Mindy Chen-Wishart, ‘Legal Transplant of Undue Influence: Lost in Translation or a Working Misunderstanding?’, *International and Comparative Law Quarterly* 62(1) · April 2013 <[https://www.researchgate.net/publication/256057447\\_Legal\\_Transplant\\_of\\_Undue\\_Influence\\_Lost\\_in\\_Translation\\_or\\_a\\_Working\\_Misunderstanding](https://www.researchgate.net/publication/256057447_Legal_Transplant_of_Undue_Influence_Lost_in_Translation_or_a_Working_Misunderstanding)> accessed 25 September 2018

general law applying to every relationship between two persons, and therefore, there was no need to provide for any specific changes when transposed into the Maltese legal system. Moreover, should there have been any changes, they would have been suitable for any dual relationship, thus leading to a situation in which Dingli's Commission did not opt for any amendments so as not to complicate matters. By contrast, Article 136 A of the Maltese Companies Act 1995, which was influenced by the English legal system could only apply to directors, and accordingly substantive changes had to be made since Maltese legislators could envisage the relationship between the director and the company and understand how to better regulate it under the Maltese economic developments. Accordingly, legislators tried to enact a tailor made provision to regulate the relationship between directors and companies in accordance to the exigencies to the Maltese jurisdiction where many family-run companies are formed (vide Chapter 1). These companies lead the duties of directors, shareholders and of the company itself to be blurred because the director and the major shareholder is the same person and a more emphasis must be placed on the company as distinct from its directors and shareholders rather than including the company and the shareholder in one category, if the separate legal personality principle of the company is important under the Maltese company law.

To fully understand such literal borrowing, the minor differences exhibited by the Maltese mandate provisions will be presented below. By contrast, as already pointed out above, substantive changes to the statutory provision in Article 136 A of the Maltese Companies Act 1995 can be observed when a general influence from the English legal system was resorted to. An analysis of the substantial differences carried out to the Maltese statute law, precisely to Article 136 A of the Maltese Companies Act 1995, will be presented to fully understand how the Maltese statute law was changed. Similarities will also be presented to grasp the level of

legal transplantation that has taken place under the Maltese legal system in this respect. As a result, therefore, to better understand the level of legal transplantation that has taken place under the Maltese legal system, a more careful scrutiny to the similarities and differences between the three legal systems can identify the adequateness of legal transplantation. To better demonstrate the influences exhibited by the Maltese legal system, a triangle shall be presented in which the Italian legal system will be one side, the English legal system another, and the direct influences of Roman law shall be the third side.

#### ***6.1.1.1 Comparison between the Maltese and Italian legal systems***

The discrepancies between the Maltese and Italian legal systems with respect to the enactment and interpretation of the mandate provisions are few and far between, and verbatim clauses were reproduced. In fact, only two differences exist.

The first difference deals with the application of the mandate provisions in which the Maltese provisions provide that the mandatary does not possess the power to personally sue a third party if the mandator is physically present in the Maltese islands. This minor difference, however, does not change the substantial element of the action that might be brought against the third party under each legal system, but rather clarifies the application and meaning of mandate law. Accordingly, this provision strengthens more the principle that a binding relationship between the mandator and the third party is the keystone of the application of mandate law. Apart from this minor discrepancy, it is observed that with respect to the other mandate provisions, the Maltese legal system has simply reproduced the Italian provisions, both linguistically and also with respect to their interpretation.

The second difference is in the approach taken by the majority of the Maltese judiciary when interpreting the term ‘company’. Whereas both Maltese and Italian statute law apply the strict separate legal personality principle of the company (vide Chapter 4), the Maltese judiciary tried to enhance it to also include shareholders and other interested stakeholders. At the beginning of the 19<sup>th</sup> century, the Maltese judiciary decided to include the significant power the shareholders exert on the company, and whose interests must be protected, but which approach was not reflected in subsequent Maltese judgments delivered from the 1960s or in Italian statute law or in Maltese statute law at that time. Maltese legislators changed their approach in 2004 wherein the shareholder and stakeholder influences have made a comeback when they decided to regulate listed companies through specific rules, and some Maltese judgments also took that approach, by which time the Italian legal influences had subsided. Consequently, it seems that both legal systems were applying the same principle of the company’s separate legal personality in a rigorous manner at times, but there were instances when the Maltese judiciary tried to deviate from the principle due to the majority of one-man companies formed in Malta (vide Chapter 1).

Accordingly, because only minor differences are observed between these two legal systems, legal transplantation from the Italian legal system to the Maltese legal system must be deemed to be effective. Literal borrowing of adaption was applied in this particular instance in a very effective manner, and its scope might have been adopted because the historical, societal, cultural and familiarity with the law played a pivotal role for the Maltese legislators and most of the judiciary.

### ***6.1.1.2 Comparison between the Maltese and English legal systems***

The same, however, is not seen when a comparison is drawn between the Maltese and English legal systems. When one compares the Maltese and English legal systems and makes a comparison between Article 136 A of the Maltese Companies Act 1995 and sections 170 *et seq* of the United Kingdom's Companies Act 2006, various substantive discrepancies can be seen (vide Chapter 4). The first two duties are the duty to act in good faith and in the best interest of the company and the duty to take care of the general governance of the company. Here, the main noticeable difference is that the Maltese legal system has opted to enact the two duties under two different headings, whereas in the English system they are combined under one: the duty to act in good faith and best interests of the company. These two duties can be said to be overlapping because directors have to ensure that the company is managed by good governance for the directors to be considered fully compliant with their duty to act in good faith and in the best interest of the company. However, they are interpreted differently because the duty to act in good faith and in the best interest of the company goes beyond the simple duty to take care of the general governance of the company. This supposition is drawn on the basis that the duty to take care of the general governance of the company simply implies that the company's accounts and any other form is duly filed with the Registry of Companies on time, and any penalty that is issued in the name of the company is promptly paid. By contrast, the duty to act in good faith and in the best interest of the company implies that directors have a duty to act reasonably in what they believe is just when they have to take a decision with respect to the company. Consequently, the duty to take care of the general governance of the company does not affect the financial position of the company, but can be only slightly affected if penalties are constantly issued and not paid on time. Yet, the same cannot be concluded with regards to the duty to act in good faith and in the best interest of the company, which implies that the financial position of the company is very much affected on the basis of what decision the

directors make. In this regard, the Maltese approach is more welcoming than the English general provision.

The next discrepancy arises under the duty not to make a secret or personal profit without the consent of the company. Whereas the Maltese legal system precludes a director from making any secret or personal profit, be it from a third party or from the company, the English system is more liberal and only precludes secret or personal gain if it is gained by the director from a third party. The difference in this approach means that under the Maltese legal system, if for example a director earns a wage, they will still technically need the consent of the company, whereas the English legal system seems to automatically give such rights to the director. Under the Maltese statutory provision, any profit may also be accepted by the directors if approved by the company but, since they act on behalf of the company, how effective such a safeguard would be is questionable. Consequently, although at first glance the provision seems to cut down on abuse, the way it is worded does not help to protect the interests of the company, and the English statutory provision is more appropriate and should be more readily accepted.

An additional difference arises under the duty not to let personal interests conflict with the interests of the company. The Maltese legal system provides for a generic approach, in which any conflict of interest is unacceptable and improper. However, the English statute provides for two situations in which conflicts of interest cannot arise, as opposed to the more stringent Maltese statutory provision. First, the English provision provides that such duty is not infringed in relation to those situations which cannot reasonably be regarded as likely to give rise to a conflict of interest. This leads to problems because such interpretation can be highly subjective and thus lead to unnecessary complications. Second, this duty will also not be breached by the

director if the matter has been authorised by the company, but a different approach is taken for public and private companies. The constitution of a private company shall not in any manner invalidate such authorisation, whereas in the case of a public company, such authorisation must be specifically laid down in the company's constitution. In view of that, the Maltese statutory provision is better than its English counterpart to better protect the interests of the company.

The next major difference occurs with respect to the duty not to use any property, information or opportunity of the company for their own or anyone else's benefit or obtain any benefit from their power, except with the consent of the company at the general meeting or as permitted by the memorandum and articles of the company. In essence, the Maltese legal system does not limit such authorisation only to the company's constitution, but also gives the right to a general meeting. By contrast, the English position is limited to the company's constitution. Accordingly, the Maltese legal system is slightly easier and less burdensome, but still achieves the desired result since the shareholders' approval is always sought, as approval for a change in the company's constitution. Therefore, at first glance, this statutory difference between the two legal systems might not seem a substantial divergence, but the Maltese statutory provision leads to the same results in a lesser time than the English provision, and the interests of the company can be more easily protected.

The fifth difference arises under the two duties outlined above. The English legal system introduced the concept of liability of directors after retirement from the office, and that a director's fiduciary duty does not end when the individual retires. Therefore, a director cannot act on the basis of any information which they gain during their appointment. The strict interpretation of this duty is important as, if a director uses any information, property or

opportunity, this can affect the financial position of the company. Regrettably, this specific statutory provision was not transplanted into the Maltese legal system, but I am of the view that such prohibition would be taken into consideration if the Maltese judiciary were to be faced with such a situation because I believe that the Maltese judiciary is a firm believer that the company's interests shall always be protected, and when the company's interests are well protected, the interests of any stakeholder are also protected.

The last difference arises with respect to the directors' duty to act within the powers conferred upon them by the memorandum and articles of association of the company or by any other agreement entered into between the director and the company. Whereas the English legal system has recently opted to include the possibility not to enact an objects clause in the memorandum and articles of association, such progressive thinking is not reflected in the Maltese legal system yet. The Maltese Companies Act 1995 puts a duty on the subscribers to always include an objects clause in the memorandum and articles of association upon incorporation of the company with the Registry of Companies.<sup>563</sup> Yet, to balance such a burden, the subscriber usually has an infinite objects clause to ensure that any action taken by the company will be within its powers. Consequently, the Maltese approach is more burdensome on the company and can lead to unnecessary complications, which the English approach has already envisaged and has decided to opt for the exclusion of the objects clause.

Another considerable discrepancy lies in the scattered provisions that were enacted in the 1964 Maltese Ordinance, the 1995 Maltese Act and the English legal system. The major difference

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<sup>563</sup> Vide Article 69

is the prohibition against the company giving loans to directors. The Maltese provision provides that a loan may be given to a director if approved by the company or if it is in the ordinary course of the company's business to give out loans. However, as directors act on behalf of the company, approval by the company entails approval by the directors themselves. The Maltese approach is only limited to the directors themselves and specifically to loans. By contrast, the English statutory provision was stricter and included the prohibitions against quasi-loans and to persons connected to the director, even if the company does not object. As a result, the English statutory provision is better suited to protecting the interests of the company.

Nevertheless, at the same time, it is observed under Chapter 4 that there were other detailed instances in which the English legal system was adequately and effectively transplanted into the Maltese legal system. This shows that literal borrowing has led in this instance to the acceptance of that legal transplantation may sometimes be effective. The no-conflict and the no-profit principles were, in fact, adopted literally in the 1962 Maltese Ordinance and retained in the Maltese Companies Act 1995. The Maltese legal system opted to incorporate these two principles with the same vigour as the English legal system, through the duty on the director to declare any interest in a proposed contract or in a contract of the company and to ensure that the personal interests do not conflict with those of the company.

Another benefit is that both legal systems forbid the misuse of the company's confidential information by a director in any circumstances. Misuse of information can take place by using the company's information not only for one's own personal interests in the course of employment as a director with the company, but also if it used for the benefit of a third party.

Chapter 4 presents another noticeable influence that is seen under both legal systems, which is with respect to the approach taken to the definition of the term ‘company’. Although a discrepancy used to exist, it was recently changed to reflect the English approach under the Maltese legal system in which one particular presiding judge has decided to link his thinking with the approach taken by the English legal system. This has, at the beginning, been limited under the Maltese legal system to include only the company *per se* as defined within the general corporate principle and, therefore, the Maltese legislators have limited such terms within the strict application of the separate legal personality concept of the company. The same rigorous interpretation was also applied by the majority of the Maltese judiciary. The English approach is very similar to the Maltese approach, in which the statute law and English judgments limit the term ‘company’ to the strict interpretation of the separate legal personality principle. Nevertheless, the English legal system has started interpreting the term ‘company’ widely, especially during the late 1990s and 2000s when discussions over the newly enacted Companies Act 2006 were under way. The English legal system has thus introduced the ESV and CSR principles to widen the interpretation of the term ‘company’, in which any stakeholder interest is also taken into consideration. These principles were not readily accepted under the Maltese legal system, and have only been cautiously introduced with respect to listed companies, although that is starting to change with a widening of the interpretation of the company for the general common good of any involved person, even though a director always has to ensure that the interests of the company are never undermined.

Two more influential necessities that were also literally reproduced into the Maltese legal system from the English system are the inclusion of the principles of ratification and personal

liability, which come into play when the director acts beyond the powers conferred by the memorandum and articles of association, or by any other agreement entered into between the director and the company. Both systems require that a company shall ratify any contract if the directors acts beyond his powers and the company shall be bound by such action. Both systems also point out that when a director acts in his own name, he is personally liable and such action cannot then be impugned to the company.

Accordingly, the above analysis shows that the Maltese legal system has not always allowed the literal borrowing to take place, as when the Maltese legal system was influenced by the Italian legal system. Yet, there were instances of literal borrowing when Maltese legislators opted to change the substantive element of certain provisions transplanted from the English legal system, or when most of the Maltese judiciary came to the conclusion that the English legal system is more attractive. This shows that certain notions were borrowed from the English legal system, but the examples also show that certain principles have been influenced by the factors identified in Chapter 1, especially the economic and prestige factors, closely linked with the historical, societal, cultural and familiarity with the law factors, which led to the enactment of distinctive laws that seem to accommodate the Maltese legal system.

### **6.1.2 Influence exerted by Roman law on the Maltese Civil Code 1870 provisions**

The second observation emanating from this thesis demonstrates that the fiduciary provisions as enacted under the Maltese Civil Code 1870 were not transplanted at all. In this particular instance, it is deduced that the factors identified in Chapter 1 which form the concept of the legal transplantation have been very influential. In fact, it is observed that the two fiduciary provisions were something that the Maltese legislators felt the need to enact to ensure that any

person exercising potential influence on the company is regulated due to the influence exerted by the unique Maltese economy and way of living. Therefore, the substantive law was totally not adapted from any foreign legal system, but was original to Malta and these provisions, codified in Articles 1124 A and B of the Maltese Civil Code 1870, were not influenced by the Italian or English legal system, but were influenced by the Roman system. The general concept of fiduciary duty has been influenced by the English legal system, but the English legal system has never opted for the statutory introduction of a general provision that regulates any fiduciary relationship that might arise between two persons. Consequently, it does not regulate persons not holding the title of a director so rigorously, even though it provides for a wide definition of director as the Maltese legal system. Likewise, the Italian legal system does not put any person holding a fiduciary position under the same heading of director, and the Italian system has never readily accepted the fiduciary concept (vide Chapter 2). By contrast, the Maltese legal system has taken the stance that any person, even if that individual does not hold the official title of director, has a fiduciary relationship with the company, the same fiduciary duty and its interpretation shall apply to that individual as to a director.

### **6.1.3 The approach taken by the majority of the Maltese judiciary distinct from statute law; thus leading to judicial nihilism**

The third remark observed from this thesis is that although the Maltese legislators took a certain path in their regulation of the fiduciary duty of directors, the majority of the judiciary have departed from this approach and applied the law as they deemed appropriate. It started to refer to the English influence in the 1940s, long before it was acknowledged by the Maltese statute law (vide Chapter 5). As a result, it has applied the law differently, which should be discouraged because the law cannot be bent in such a way that the involved parties are prejudiced. Whenever a judge or magistrate applies the law inappropriately, the involved

parties have not been protected by the law as they should have been. The study shows that, although the Maltese statute law has applied both the Italian and English legal systems over time, the majority of the Maltese judiciary did not observe such smooth development. Statutory transitioning was, as a result, not applied by most of the Maltese judiciary. In fact, there were judgments decided on Article 136 A of the Companies Act 1995 even if they were filed before 2003 whereas there were others decided on mandate law even if they were filed after 2003. The Maltese judiciary can be regarded as guilty of judicial nihilism due to its inconsistency in applying the law, not as it was written, but as they deemed appropriate. Judicial nihilism, therefore, shall be defined as those instances whereby most of the judiciary were not applying the law as it was enacted by the legislators but were departing from such definitions of the law to apply the law they deemed appropriate (vide Chapter 1).

#### **6.1.4 A general approach to legal transplantation in the Maltese legal system**

Although this thesis presents the study of the fiduciary duty of directors as presented under Maltese statute law and its interpretation of this duty by the Maltese judiciary, it would have been interesting to look at other areas of Maltese law to fully comprehend the type and level of borrowing reflected in the Maltese legal system. As a general rule, shipping<sup>564</sup> and aviation laws<sup>565</sup> are very much modelled on the English legal system wherein literal borrowing seems to have taken place. Private law, by contrast, seems to have been more influenced by the civil legal system,<sup>566</sup> even though property law, which also forms part of private law, was surely

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<sup>564</sup> The Law Review, The Shipping Law Review Edition 5, (2018) <<https://thelawreviews.co.uk/edition/the-shipping-law-review-edition-5/1171085/malta>> accessed 17 August 2018

<sup>565</sup> Reference to the influence of the English legal system was made during the law course at the University of Malta

<sup>566</sup> Ivan Sammut, 'the EU and Maltese Legal Orders: What Kind of Marriage Between Them?' 97 <[http://www.um.edu.mt/europeanstudies/books/CD\\_CSP5/pdf/isammut.pdf](http://www.um.edu.mt/europeanstudies/books/CD_CSP5/pdf/isammut.pdf)> accessed 3 October 2018

influenced by the uniquely congested real estate situation in Malta.<sup>567</sup> Hence, as a result, it may be concluded that the factors defined in Chapter 1 and applied with respect to the regulation of the fiduciary duty of directors may well be reflected in other parts of Maltese law, depending which area of law is being examined. Accordingly, such approach reinforces once again that while legal transplantation in Malta cannot be undermined, the historical, cultural, societal, familiarity with the law, judicial, economic, prestige and political factors have uniquely shaped the Maltese legal system, in every aspect of the law. It is also observed that whenever legal transplantation takes place in any area of the Maltese law, such borrowing does not depend if it was due to the civil or common law influences, but every borrowing depends on the Maltese context as influenced by the various factors mentioned herein and defined in Chapter 1. Therefore, there may be literal borrowing from the English legal system, as in the case of shipping and aviation, as much as the literal borrowing from the Italian system.

## **6.2 Explanatory factors**

This thesis presents my understanding that there is a real need for transplanting law into the Maltese legal system because legal transplantation addresses defects, which arise from concerns about the inadequacy of legal interpretation, the problem of uncertainty in law and deficiency in legislation. Nevertheless, legal transplantation is influenced by the application of the diverse factors presented in Chapter 1 of this thesis.

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<sup>567</sup> Two major provisions include the regulation of the common wall between two properties and the excavation rules when two properties share a common wall

In this regard, indeed, first and foremost, I have presented the Maltese legislators' behaviour with respect to the trajectory of the law. I have demonstrated that Maltese legislators opted for legal transplantation as influenced by the language and historical preferences, which have led to the application of the Italian legal system and later superseded by the English legal system. I have, however, also demonstrated that over time, Maltese legislators have shown another reason for the application of legal transplantation, which is due to the prestige and market practice that the Italian and English legal systems have enjoyed throughout the years, especially the English legal system as London has gained prominence in the financial sector. I also reckon that another most obvious reason, and one which seems to be readily accepted Maltese legal scholars, is that legal transplantation from the Italian and English legal systems was also effective in Malta because the Maltese legislators have always tried to enact laws based on the legal system whose laws are considered to be influential at that time. The Italian legal system was influential during the time when the various factors mentioned in Chapter 1 required them to take into consideration the mandate provisions as enacted under the Italian legal system. The Italian influence was very strong in Malta for quite a long time, both from a statutory point of view and also from the majority of the judiciary's approach. This changed after the 1940s whereby Maltese legislators and most of the judiciary began to look up to the English legal system. This sentiment was influenced by the historical, economic and prestige factors mentioned and became entrenched as London became the major hub in the field of finance and corporate law. Consequently, it was deemed that the English laws would be effective in regulating any aspect of finance and corporate law since Malta greatly depends on foreign investments for success. Accordingly, various specific provisions were enacted in the Maltese Commercial Ordinance 1964 and in the Maltese Companies Act 1995, including the duty of directors.

Second, I have also established that legal transplantation was also effective when it was resorted to by the judiciary to fill gaps where the law was silent or ambiguous. In this case, most of the Maltese judiciary opted to look at that foreign legal system that enjoys a certain degree of prestige and one, which enjoys a strong economy. As a result, it may be presented that legal transplantation can be an effective solution to address the gaps in legislation, and Maltese statute law is sometimes silent on certain notions, but due to the influences exerted by the Italian and English legal systems as applied through the various factors presented in Chapter 1 of this thesis, references to these systems shall be made when necessary. Chapter 5 shows even more clearly that most of the Maltese judiciary have demonstrated that reference to foreign legal systems, especially to the English legal system, can be made when the Maltese statute law is silent on a certain notion.

However, I have also shown throughout this study that although legal transplantation is significant and cannot be undermined, any rule transplanted into the Maltese statute law or delivered through judgments may not be as effective as they are in their countries of origin for two reasons: first, the factors identified in Chapter 1 and the nature of the Maltese economy provide a different environment to that which the foreign legislation was designed to fit; and second, the application of the concept of judicial nihilism cannot be undermined. This judicial nihilism, indeed, shall be defined as those instances whereby most of the judiciary were not applying the law as it was enacted by the Maltese legislators but were departing from such definitions of the law to apply the law they deemed appropriate, as also discussed in section 1.2.3 of this thesis.

With regards to the first limb identified above, it is true to note that foreign norms and institutions are diffused into the Maltese legal context during the legislative process, which are, however, influenced by the identified factors in Chapter 1. Moreover, if none of the foreign systems available seems to be suitable for the particular case of Malta, these rules need to be changed in their entirety, perhaps into something that departs greatly from the original. For example, I theorize that Maltese statute law had to undergo certain changes due to the commercial implications in Malta such as always using the term ‘company’ to try and present a situation where the company is not a sham invention with a wider definition presented by some of the Maltese judiciary by applying the not-so-readily accepted ESV and CSR principles as much as possible to ensure that any interests are protected; but which two principles are being rigorously applied for listed companies through the enactment of the listing rules with no exceptions. The reason for the statutory resistance to these two principles, as presented by some of the Maltese judiciary, may have been that many companies are family run businesses in Malta with the shareholder and the director one and the same person, as delineated in Chapter 1. These principles, however, are being rigorously applied to listed companies because these companies are made up of different shareholders who are separate from the directors and the creditors’ protection is also not undermined. This reason, through the presentation of the unique Maltese business context, has, accordingly, also provided an answer to the notion why few judgments were ever filed in the Maltese Courts challenging the fiduciary duty of directors since the fiduciary duty can only be challenged by one director in the name of the company against another director.

As to the second problem of judicial nihilism, and therefore, the application of the law by various judges and magistrates inconsistent with how the law was enacted, can be observed through the challenge presented by the level of judicial education. One can observe from this

study that legal transplantation in Malta might not have been fully effective because the majority of the Maltese judiciary did not interpret the statute law correctly. Such misinterpretation of statute law may have arisen due to three distinctive facts. First, every judge might have had other definitions in mind, influenced by the distinctive social background which that judge lives in. Moreover, the fact that the law of precedent is not enforced in Malta and dissenting opinions by the judiciary are not written are two further factors that also lead to a situation in which any judge can decide on their own social norms. Second, whereas it is true that every judge attends the same course in Malta, postgraduate studies and the importance of speaking Italian well are not enforced. Accordingly, a judge might not be able to fully understand and interpret the statute law and foreign judgments correctly. Third, every judge or magistrate can sit on every court and can hear any case, thus they lack specialisation.

### **6.3 Wider implications and the relevance of studying the complexities of Malta**

As a first point, this study adds to the general study of legal transplantation by having presented the complex dynamics presented by the Maltese legal system through the application and interpretation of the fiduciary duty of directors as presented by the Maltese statute law and judiciary from the 19<sup>th</sup> century to the present day. In fact, more precisely, I present, for the first time, that legal transplantation in the Maltese legal system in the fiduciary duty of company directors is not straightforward as Watson believes, but neither can it be totally ignored and overlooked, as Montesquieu, Legrand and Siedmans believe. As a result, I shall conclude that such legal transplantation can take place within the limits imposed by the various factors presented in Chapter 1.

I have presented that these factors, namely the historical, cultural, societal and familiarity with the law, led to the Italian legal system to be closely imitated and literal borrowing was, therefore, adopted by the legislators in Malta from the 1800s. These same factors, nevertheless, contributed to substantial modifications, which were considered necessary when the influence of the English legal system started to increase from the 1940s until the enactment of Article 136 A in the Maltese Companies Act 1995 in 2003 because not all aspects of the application of this foreign legal system were considered to complement the legislative rules of the Maltese legal system and its custom. However, I have shown in this thesis, especially in Chapter 4, that further changes to the Maltese statutory provisions should be considered appropriate and necessary. I thus propose four amendments, which will be outlined herein, and which are characterised as suitable and proper. The first example of a much-needed change to Maltese statute law is to include a provision to require directors to continue abiding by their fiduciary duty even after their retirement or resignation from office. This amendment would ensure that any director cannot use any acquired knowledge to gain money out of it to the detriment of the company that they used to work for. The second amendment that would surely be very welcoming is to include under the Maltese law the prohibition of giving out also quasi-loans to directors, and not only loans. The reason for such inclusion is that in a quasi-loan, the requirement of a debtor, in which case is the director, to repay the amount back to the principal, being the company, would not necessarily be included in the terms and conditions. Therefore, the fact that a repayment date is not included can work very much against the best interest of the company because the company may end up without that amount of money owed to it. One might argue that the providing of quasi-loans or loans to directors would not result in a detriment to the company in a one-man company where the shareholder and the director of the company is the same persona since if a company makes any profit or otherwise would still be for the benefit of the director. However, allowing the providing of quasi-loans and loans would

inhibit the application of the separate legal personality of the company. This is because whatever structure of the company is, including a one-man company, the company shall always enjoy a separate legal entity from its shareholders and it shall, therefore, always be paid back any amount owed to it, whatever the circumstance. Should the company not be paid back any amount loaned, such approach would mean that the best interest of the company is not taken into consideration. The providing of loans and quasi-loans to directors by companies also works against the enlightened shareholder value (ESV) principle when there is not a one-man company. The corporate social responsibility (CSR) principle shall also be taken into consideration wherein the providing of loans or quasi-loans by the company to directors would always be seen as working against the interest of stakeholders because should the company go into liquidation to the amounts owed, its employees and creditors would be left in a disadvantageous position. The third change is to include any person associated with a director; therefore the prohibition to give out loans and quasi-loans shall not only be limited to directors but also to family member and to any other person, whether legal or natural, which is linked to the director, either directly or indirectly. The reason for such prohibition is because approval to any loan is sought for by the company only under Article 136 A of the Companies Act 1995 which would mean that the directors only need to give their consent who would surely consent to the giving out to loans to any person linked to themselves. Also, such prohibition shall be included under Article 144 of the Companies Act 1995 since consent under this Article is only sought for at a general meeting, which would be tainted if the director is the major shareholder who would, once again, consent to the providing of the loan to any person linked to themselves. One final amendment that needs to be taken into consideration is the abolishing of including an objects clause in the memorandum and articles of association upon company formation because a very wide objects clause is still being included by promoters upon company

formation and ratification can also take place; both instances defeat the purpose of having an objects clause included.

Nonetheless, at the same time, I am of the opinion that this study has also demonstrated that the manner in which statute law is being defined takes into consideration the fact that the majority of companies in Malta are family run businesses and are, therefore, categorized as small and medium enterprises, as demonstrated in Chapter 1. I demonstrated through this study that cultural and social norms have shaped the Maltese legal system in a unique manner. In this respect, I demonstrated that these norms have led to the ESV and CSR principles to never be explicitly included under Article 136 A of the Companies Act 1995, but were introduced in the listing rules and shall, accordingly, apply with respect to listed companies and also applied by some members of the judiciary. The reason for such approach is because as I have demonstrated throughout, the majority of companies in Malta are one-man companies; therefore the ESV and CSR principles were already indirectly included because a director of a company would surely work for the benefit of the shareholder, who would be the sole or major shareholders themselves. They would also work in favour of other stakeholders, as they are aware that should they maximize profits they can declare more profits for themselves, which profits can be increased when creditors and employees are respected and work closely with the director who acts for and on behalf of the company.

I have also shown throughout this study that a difference arises between the trajectory of the legal transplantation concept in statute law and its interpretation by the majority of the judiciary who have not always correctly applied the law in line as it was transplanted, thus leading to the application of the concept of judicial nihilism, which is defined in Chapter 1. In fact, it is

demonstrated that most of the judiciary were more interested in the economic and prestige factors from the 1940s, which have thus departing from the historical, societal and cultural factors, together with the familiarity with the law. This judicial approach led to the need and desire to make reference to the English system, way before the legislators in Malta opted to start to look at this foreign legal system. I have also shown and discussed the notion that the majority of the judiciary could apply the economic and prestige factors since all of the judiciary enjoy judicial independence who cannot be removed, as explained in Chapter 1. In fact, scholars believe that judicial independence is very important to economic and financial development.<sup>568</sup> Nonetheless, I have also provided for a new insight on the importance of judicial training and education. I strongly believe that judicial training and education are important and cannot be undermined, as the judiciary needs to be aware of all the changes and developments that take place in statute law so that they can fully interpret and apply the law. Judges and magistrates must also educate themselves about the diverse factors that have led to any amendments in statute law to be in a position to fully comprehend the amended law. In view of this, three changes to the judicial system should be considered. First, changes to the appointment of the judiciary shall be made where judges and magistrates shall be appointed according to their specialisation, in view of which a judge or a magistrate who has specialized in company law shall only have competence to decide on such cases. Therefore, judges and magistrates should not enjoy the right to sit on any case, as happens in Malta today. Second, the whole judiciary must ensure that all of its judges and magistrates are applying the correct law to eliminate any ambiguities that may arise, as was demonstrated in Chapter 5. The correct application of the law can only be achieved if the judiciary informs itself of any amendments carried out to statute law and must also be trained in better understanding the origin of these

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<sup>568</sup>Kim (n 88)

amendments so they would be in a position to fully comprehend the true meaning of the wording used, especially when a particular law is literal borrowed from a foreign system. Therefore, the legal transplantation notion and its influence on a certain part of the law needs to be very well understood so that every judge and magistrate is in a position to fully comprehend and interpret statute law effectively. Nonetheless, this does not mean that the judiciary shall start to apply the law of precedent, but such law shall continue not to be applied in the Maltese context and both judges and magistrates shall continue to enjoy the right to interpret the law, as they deem fit and appropriate. However, all of the judiciary shall the least apply the same law; therefore, as a result, by way of example, should a case is raised before the Maltese Courts about the fiduciary duty of directors, any judge or magistrate shall apply Article 136 A of the Maltese Companies Act 1995 while reference to mandate law and to the old judgments that have applied mandate law shall not be made. This study has also provided for the importance of having the Maltese judiciary enjoying the opportunity to write dissenting opinions without fear of being reprimanded, which dissenting opinions can ultimately lead to alternative interpretations of the law, which can result in a better understanding of the law.

Accordingly, I have demonstrated, for the first time, how the fiduciary duty of company directors in Malta is applied and interpreted under the Maltese statute law and by the Maltese judiciary through the legal transplantation concept. More precisely, I have shown the importance of applying the legal transplantation concept in the Maltese legal system, subject to the factors presented under Chapter 1. I have, more accurately, presented, for the first time until to date the dynamic complexity of the Maltese legal system, which could be presented and analysed through the Maltese statute law and the unique Maltese judicial interpretation of the fiduciary duty of directors through the application of the legal transplantation concept. Hence, although it is true to assert that most of the Maltese legal scholars are aware that the

interpretation of the fiduciary duty of directors was influenced first by the Italian legal system and thereafter by the English legal system, none of them has ever taken the time to fully analyse the extent of legal transplantation with regard to this fiduciary duty in the Maltese context and the Maltese judiciary's approach to this duty of directors until to date.

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## Appendix

Articles and sections mentioned in the thesis are reproduced in this Appendix for ease of reference.

### **Maltese Statute Law**

#### *Constitution of Malta*

**Article 96** states that (1) The judges of the Superior Courts shall be appointed by the President acting in accordance with the advice of the Prime Minister.

(2) A person shall not be qualified to be appointed a judge of the Superior Courts unless for a period of, or periods amounting in the aggregate to, not less than twelve years he has either practised as an advocate in Malta or served as a magistrate in Malta, or has partly so practised and partly so served.

(3) Without prejudice to the provisions of sub-article (4), before the Prime Minister gives his advice in accordance with sub-article (1) in respect of the appointment of a judge of the Superior Courts, (other than the Chief Justice) the evaluation by the Judicial Appointments Committee established by article 96A of this Constitution as provided in paragraphs (c), (d) or (e) of sub-article (6) of the said article 96A shall have been made.

(4) Notwithstanding the provisions of sub-article (3), the Prime Minister shall be entitled to elect not to comply with the result of the evaluation referred to in sub-article (3): Provided that after the Prime Minister shall have availed himself of the power conferred upon him by this sub-article, the Prime Minister or the Minister responsible for justice shall:

(a) publish within five days a declaration in the Gazette announcing the decision to use the said power and giving the reasons which led to the said decision; and

(b) make a statement in the House of Representatives about the said decision explaining the reasons upon which the decision was based by not later than the second sitting of the House to be held after the advice was given to the President in accordance with sub-article (1): Provided further that the provisions of the first proviso to this sub-article shall not apply in the case of appointment to the office of Chief Justice.

**Article 100** states that (1) Magistrates of the inferior courts shall be appointed by the President acting in accordance with the advice of the Prime Minister.

(2) A person shall not be qualified to be appointed to or to acting the office of magistrate of the inferior courts unless he has practised as an advocate in Malta for a period of, or periods amounting in the aggregate to, not less than seven years.

(3) Subject to the provisions of sub-article (4) of this article, a magistrate of the inferior courts shall vacate his office when he attains the age of sixty-five years.

(4) The provisions of sub-articles (2) and (3) of article 97 of this Constitution shall apply to magistrates of the inferior courts.

(5) Without prejudice to the provisions of sub-article (6), before the Prime Minister gives his advice in accordance with sub-article (1) in respect of the appointment of a magistrate of the Inferior Courts the evaluation by the Judicial Appointments Committee established by article 96A of this Constitution as provided in paragraphs (c), (d) or (e) of sub-article (6) of the said article 96A shall have been made.

(6) Notwithstanding the provisions of sub-article (5), the Prime Minister shall be entitled to elect not to comply with the result of the evaluation referred to in sub-article (5): Provided that after the Prime Minister shall have availed himself of the power conferred upon him by this sub-article, the Prime Minister or the Minister responsible for justice shall: (a) publish within

five days a declaration in the Gazette announcing the decision to use the said power and giving the reasons which led to the said decision; and(b) make a statement in the House of Representatives about the said decision explaining the reasons upon which the decision was based by not later than the second sitting of the House to be held after the advice was given to the President in accordance with sub-article (1).

### ***Ordinance XIII 1857***

**Article 62** states that an anonymous partnership can be managed by agents or by directors appointed for a time, or by agents and directors conjointly, being liable to removal, whether partners or not, whether receiving a salary or acting gratuitously.

**Article 63** states that the managing partners are under no obligation that that of fulfilling the charge received. They contract by reason of such management no obligation, either personal or in solidum, in reference to the engagements of the partnership.

**Article 69** states that previously to the making of any such enrolment, exhibition, or publication, the parties acting as managers of an anonymous partnership shall be liable, both personally and in solidum, for their operations to third parties.

### ***Act XXX of 1927***

**Article 3** states that in commercial matters, the commercial laws shall apply, if no provision exists in such laws, the mercantile custom shall be applied, and in the absence, the civil law.

## *Commercial Code 1942*

**Article 3** states that in the absence of commercial law and custom usages, the fiduciary duty of directors shall be governed by the Maltese civil code.

**Article 153** states that a partnerships anonyme or limited liability company is formed by means of a capital divided into a certain number of shares; it does not take its name from any one of its partners; but it may take its name from the object of the undertaking, or may even be designated by a title.

**Article 155** states that a limited liability company shall be administered by one or more agents or directors appointed for a certain time, or by one or more agents and directors conjointly, subject to removal, whether chosen from amongst the partners or not, whether salaried or otherwise.

**Article 156 (1)** states that the administrators are only responsible for the due execution of their mandate. They do not incur by reason of their management any liability, either personally or jointly and severally, with respect to the engagements of the partnership.

**Article 156 (2)** states that nevertheless, in case of breach of any of the provisions contained in the deed of partnership, or in case of non-fulfilment of their duties, the administrators become personally liable to third parties for any damage occasioned to them.

**Article 162** states that until such enrolment, production and publication, as prescribed in sections 158, 160 and 161 are made, the parties acting as administrators of a limited liability company shall be personally and jointly and severally liable for their dealing towards third parties.

### ***Commercial Partnerships Ordinance 1962***

**Article 2** states that a 'director' includes any person occupying the position of director by whatever name called.

**Article 3** states that commercial partnerships shall be governed by this Act:- Provided that where no provision is made in this Act, the usages of trade or, in the absence of such usages, the Civil Law shall apply.

**Article 121 (1)** states that the business of a company shall be managed by one or more directors, who may exercise all such powers of the company as are not, by this Ordinance or by the memorandum or Articles of the company, required to be exercised by the company in general meeting.

**Article 126 (1)** states that a director may not, in competition with the company and without the approval of the company given at a general meeting, carry on business on his own account or on account of others or be a partner with unlimited liability in another partnership. (2) Where a director acts in violation of the prohibition contained in this section, the company may, at its

option, either take action for damages and interest against him or demand payment of any profits made by him in contravention of this section.

**Article 127** states that it shall not be lawful for a company

(a) to make a loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person: Provided that nothing in this section shall apply either

(i) to anything done, with the approval of the company given at a general meeting, to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; or

(ii) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business;

(b) to make to any director of the company any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, without particulars with respect to the proposed payment (including the amount thereof) being disclosed to members of the company and the proposal being approved by the company in general meeting.

**Article 128** (1) states that it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contractor proposed contract with the company to declare the nature of his interest to the other directors either at the meeting of the directors at which the question of entering into the contract is first taken into consideration, or, if the director was not at the date of that meeting interested in the contract or proposed contract, at the next meeting of the directors held after he became so interested.

(2) Any director who fails to comply with the provisions of this section shall be liable to a penalty not exceeding one thousand and one hundred and sixty-four euro and sixty-nine cents (1,164.69).

***Companies Act, Chapter 386 of the Laws of Malta***

**Article 4** (4) states that a commercial partnership as a legal personality distinct from that of its member or members and such legal personality shall continue until the name of the commercial partnership is struck off the register, whereupon the commercial partnership shall cease to exist.

**Article 127** states that it shall not be lawful for a company

(a) to make a loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person: Provided that nothing in this section shall apply either

(i) to anything done, with the approval of the company given at a general meeting, to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the

purpose of enabling him properly to perform his duties as an officer of the company; or

(ii) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business;

(b) to make to any director of the company any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, without particulars with respect to the proposed payment (including the amount thereof) being disclosed to members of the company and the proposal being approved by the company in general meeting.

**Article 136 A** states that: (1) A director of a company shall be bound to act honestly and in good faith in the best interests of the company.

(2) The directors of a company shall promote the well-being of the company and shall be responsible for:

(a) the general governance of the company and its proper administration and management; and

(b) the general supervision of its affairs.

(3) In particular, but without prejudice to any other duty assigned to the directors of a company, or to any one of them, by the memorandum or articles of association or by this Act or any other law, the directors of a company shall:

(a) be obliged to exercise the degree of care, diligence and skill which would be exercised by a reasonably diligent person having both

(i) the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and

(ii) the knowledge, skill and experience that the director has;

(b) not make secret or personal profits from their position without the consent of the company, nor make personal gain from confidential company information;

(c) ensure that their personal interests do not conflict with the interests of the company;

(d) not use any property, information or opportunity of the company for their own or anyone else's benefit, nor obtain benefit in any other way in connection with the exercise of their powers, except with the consent of the company in general meeting or except as permitted by the company's memorandum or articles of association;

(e) exercise the powers they have for the purposes for which the powers were conferred and shall not misuse such powers.

**Article 137** (2) states that the business of a company shall be managed by the directors who may exercise all such powers of the company, including those specified in Article 136, as are not by this Act or by the memorandum or Articles of the company, required to be exercised by the company in general meeting.

**Article 137** (3) states that the business of a company shall be managed by the directors who may exercise all such powers of the company, including those specified in Section 136 of this Act as are not by this Act or by the memorandum or Articles of the company, required to be exercised by the company in general meeting'.

**Article 143** (1) states that a director of a company may not, in competition with the company and without the approval of the same company given at a general meeting, carry on business on his own account or on account of others, nor may he be a partner with unlimited liability in another partnership or a director of a company which is in competition with that company.

**Article 144** (1) states that it shall not be lawful for a company

(a) to make a loan to any person who is its director or a director of its parent company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person: Provided that nothing in this paragraph shall apply either

(i) to anything done, with the approval of the company given at a general meeting, to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; or

(ii) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other

persons, to anything done by the company in the ordinary course of that business;

(b) to make to any director of the company any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, without particulars with respect to the proposed payment, including the amount thereof, being disclosed to members of the company and the proposal being approved by the company in general meeting.

(2) For the purposes of this Article, the expression ‘director’ shall include any person in accordance with whose directives or instructions the directors of a company are accustomed to act.

**Article 145** (1) states that it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest to the other directors either at the meeting of the directors at which the question of entering into the contract is first taken into consideration or, if the director was not at the date of that meeting interested in the contract or proposed contract at the next meeting of the directors held after he became so interested.

(2) Any director who fails to comply with the provisions of this section shall be liable to a penalty.

***Civil Code, Chapter 16 of the Laws of Malta***

**Article 1124 A** states that: (1) Fiduciary obligations arise in virtue of law, contract, quasi-contract, trusts, assumption of office or behaviour whenever a person (the ‘‘fiduciary’’)

(a) owes a duty to protect the interests of another person; or

(b) holds, exercises control or powers of disposition over property for the benefit of other persons, including when he is vested with ownership of such property for such purpose; or

(c) receives information from another person subject to a duty of confidentiality and such person is aware or ought, in the circumstances, reasonably to have been aware, that the use of such information is intended to be restricted.

(2) A person who is delegated any function by a fiduciary and is aware, or should, from the circumstances, be aware, of the fiduciary obligations shall also be treated to be subject to fiduciary obligations.

(3) Fiduciary obligations arise from behaviour when a person –

(a) without being entitled, appropriates or makes use of property or information belonging to another, whether for his benefit or otherwise; or

(b) being a third party, acts, being aware, or where he reasonably ought to be aware from the circumstances, of the breach of fiduciary obligations by a fiduciary, and receives or otherwise acquires property or makes other gains from or through the acts of the fiduciary.

(4) Without prejudice to the duty of a fiduciary to carry out his obligations with utmost good faith and to act honestly in all cases, a fiduciary is bound, subject to express provision of law or express terms of any instrument in writing excluding or modifying such duty, as the case may be –

(a) to exercise the diligence of a *bonus pater familias* in the performance of his obligations;

- (b) to avoid any conflict of interest;
  - (c) not to receive undisclosed or unauthorised profit from his position or functions;
  - (d) to act impartially when the fiduciary duties are owed to more than one person;
  - (e) to keep any property as may be acquired or held as a fiduciary segregated from his personal property and that of other persons towards whom he may have similar obligations;
  - (f) to maintain suitable records in writing of the interest of the person to whom such fiduciary obligations are owed;
  - (g) to render account in relation to the property subject to such fiduciary obligations;
- and
- (h) to return on demand any property held under fiduciary obligations to the person lawfully entitled thereto or as instructed by him or as otherwise required by applicable law.

(5) In addition to any other remedy available under law, a person subject to a fiduciary obligation who acts in breach of such obligation shall be bound to return any property together with all other benefits derived by him, whether directly or indirectly, to the person to whom the duty is owed.

(6) The obligation to return property derived from a breach of a fiduciary duty shall apply also to all property into which the original property has been converted or for which it has been substituted.

**Article 1124 B** states that: (1) When the ownership of property is vested in a person who holds it subject to fiduciary obligations, third parties may act in relation to such person as though he were the absolute owner thereof.

(2) When a person holds property subject to fiduciary obligations, such property is not subject to the claims or rights of action of his personal creditors, nor of his spouse or heirs at law.

(3) A person dealing with a fiduciary in relation to property subject to fiduciary obligations need not -(a) enquire into the terms of his authority; or(b) obtain the consent of the person to whom the fiduciary duties are owed or any other person, and shall, subject to being in good faith, be entitled to rely on declarations made by the fiduciary with regard to his authority.

(4) The fiduciary may furnish to any person dealing with him a certificate containing the following information without being in breach of any confidentiality obligations:(a) that the authority exists, the date the relevant instrument was executed and that the authority has not been revoked;(b) a declaration that he is authorised to carry out the transactions being entered into; and(c) the identity and address of the fiduciary.

(5) Any fiduciary who issues any certificate containing any statement which he knows or ought to know is false shall be guilty of an offence and shall on conviction be liable to the punishment of imprisonment for a term not exceeding two years or to a fine(*multa*).

**Article 1856** states that: (1) Mandate or procuracy is a contract in which a person gives to another the power to do something for him.

(2) The contract is not perfected until the mandatary has accepted the mandate.

**Article 1857** states that: (1) Every mandate must have for its object something lawful which the mandator might have done himself.

(2) Subject to any other special provision of the law, a mandate can be granted by a public deed, by a private writing, by letter, or verbally, or even tacitly.

(3) An irrevocable mandate granted by way of security as specified in Article 1887(1) shall be granted in writing on pain of nullity.

**Article 1858** states that the acceptance on the part of the mandatary may also be tacit, and may be inferred from acts.

**Article 1859** states that any person carrying on trade or exercising a profession who, without just cause, fails to give notice to the mandator, without delay, of his refusal to accept a mandate relating to commercial or to professional business, as the case may be, is answerable to the mandator for damages occasioned by the delay.

**Article 1860** states that if a mandate is granted by a private writing, the name of the mandatary may be left in blank; in which case, so long as the name is not written, the bearer of the writing or of the instrument or procuration shall be deemed to be the mandatary.

**Article 1861** states that a mandate is gratuitous, unless there is a stipulation to the contrary.

**Article 1862** states that a mandate is either special, if it is for one matter or for certain matters, only; or general, if it is for all the affairs of the mandator.

**Article 1863** states that: (1) A mandate made out in general terms applies only to acts of administration.

(2) The power to make alienations of property, except such alienations as fall within the limits of the administration, or to hypothecate property or to perform other acts of ownership, must be expressed.

**Article 1864** states that a mandatary cannot do anything beyond the limits of the mandate.

**Articles 1864 A** states that: (1) A mandate given by a person of full age in anticipation of his incapacity to a mandatary, for the latter to take care of the mandator or to administer his property shall be drawn, under pain of nullity by a notary public in the presence of two witnesses in accordance with the requirements of Article 655(1) of this Code, after having obtained a medical declaration that circumstances so require in the best interests of that person. This mandate shall be registered in the same manner as any one of the acts mentioned in Article 50 of the Notarial Profession and Notarial Archives Act.

(2) In the case of a person of full age, performance of the mandate shall be conditional upon the occurrence of the incapacity and after obtaining the necessary approval from the court of voluntary jurisdiction upon application by the mandatary designated in the act. The court of voluntary jurisdiction may impose those conditions that it may deem necessary.

(3)(a) For the purpose of termination of the mandate, that termination has to be drawn by a notary public in the same manner as the mandate was constituted and the termination shall be accompanied by a sworn medical certificate which confirms that the incapacity has ceased and that termination has to be approved by the court of voluntary jurisdiction. That termination shall be registered in the same manner as any one act mentioned in Article 50 of the Notarial Profession and Notarial Archives Act.

(b) Such termination shall be communicated or notified, as the case may be, to the mandatary who shall be bound to cease from representing the mandator with immediate effect. The registrar of the court of voluntary jurisdiction shall send a copy of the termination approved by the court of voluntary jurisdiction to the Chief Notary to Government who shall enter the particulars of such termination in a register held by him for the purpose and which shall be accessible to the public during office hours.

(c) If the mandatary continues to represent the mandator after the termination has been communicated or notified to him, the mandatary shall be held personally responsible for damages and shall be considered as acting in contravention of this Article.

(4) The provisions of sub-title II of Title XVIII of Part II of Book Second of the Code shall, *mutatis mutandis*, apply to a mandatary appointed in terms of this Article.

**Articles 1865** states that: (1) For the carrying out of the mandate, the mandatary may institute legal proceedings; make and prosecute appeals; make proof by reference to the oath of his adversary; take the oath in litem or the suppletory oath; enforce judgments both on movable and immovable property; make demand for the issue of precautionary acts including those for the issue of which an application or declaration on oath is required; make demand for the personal arrest of the debtor of the mandator, where such demand is competent; and do any

other thing which the mandator might do personally, notwithstanding that such powers have not been expressly given in the mandate.

(2) The mandatary may also, in virtue of the said powers, be a defendant on behalf of the mandator, in any law-suit concerning the matter included in the mandate.

**Article 1866** states that a mandatary, however, may not sue or be sued, on behalf of the mandator, although the latter shall have given him authority to do so, when the mandator himself is not absent from the Island in which the action is to be tried, saving the provisions of Article 786 of the Code of Organisation and Civil Procedure: provided that a mandatary under an irrevocable mandate granted by way of security may sue on behalf of the mandator irrespective of this provision to protect or enforce the interests secured by the mandate.

**Article 1867** states that: (1) The express power to compromise does not include the power to submit to arbitration or vice versa.

(2) The power to receive includes the power to give acquittance.

(3) The power to sell includes the power to receive the price.

**Article 1868** states that where a person has been employed to do something in the ordinary course of his profession or calling, without any express limitation of power, such person shall be presumed to have been given power to do all that which he thinks to be necessary for the carrying out of the mandate, and which, according to the nature of the profession or calling aforesaid, may be done by him.

**Article 1869** states that minors may be appointed mandataries; but in any such case the mandator cannot maintain an action against the mandatory except in accordance with the general rules relating to the obligations of minors.

**Article 1870** states that: (1) The mandator can, for the execution of a contract, act directly against the person with whom the mandatory in his capacity as such has contracted.

(2) The powers of the mandator in relation to the subject matter of the irrevocable mandate by way of security may be suspended by express agreement for the duration of the mandate.

(3) Such mandates may be registered in a public register. In this Article 'public register' means:

(a) where the subject matter of the mandate is a ship or rights related or connected therewith, the Register of Maltese Ships and by means of an annotation;

(b) where the subject matter of the mandate is an aircraft or an aircraft engine or rights related or connected therewith, the National Aircraft Register and by means of an annotation; and

(c) in all other cases, the Public Registry by means of a note, and in such case it shall have effect in relation to third parties and any exercise of any such powers by the mandatory as are suspended shall not have any effect except when done with the written consent of the mandatory.

**Articles 1871** states that: (1) When the mandatory has acted in his own name, the mandator cannot maintain an action against those with whom the mandatory has contracted, nor the latter against the mandator.

(2) In any such case, however, the mandatory is directly bound towards the person with whom he has contracted as if the matter were his own.

**Article 1871 A** states that: (1) Any person holding property for another holds property subject to fiduciary obligations to the person engaging him for such purpose and shall be regulated by the provisions of this title and by the provisions of this Code relating to fiduciary obligations.

(2) Where such person acquires property in his own name but on behalf of a mandator, the mandator shall at all times be entitled to demand the immediate and unconditional transfer thereof from the mandatory. The mandatory shall on such demand or, in any case, on the expiration of the time during which the mandate was to continue, immediately render account of his mandate in terms of Article 1875 and transfer the property to the mandator by such means as may be appropriate, saving any special terms of the mandate relating to fees and expenses and rights of any third party in good faith.

(3) Notwithstanding Article 1886, a mandate in favour of a person acting in terms of this Article shall not lapse -

(a) on the death of the mandator and shall continue to bind the mandatory to preserve the property and all rights related thereto until such time as the property held by him is validly transferred to the heirs or legatees of the mandator; and

(b) on the bankruptcy of the mandator or the mandatory and shall continue to bind the mandatory to preserve the property and all rights related thereto until such time as the property held by him is validly transferred as directed by the competent court for the benefit of the mandator or of the creditors of the mandator, as the case may be.

(4) A term of the mandate purporting to bind a mandatory as referred to above to transfer the property held by him to a third party after the death of the mandator shall not be valid unless such bequest be made by means of a will in accordance with the formalities required by law.

(5) In the event of the death of the mandatory, the heirs at law or the executor, if any, of the will of the mandatory shall be bound by the same obligations to preserve the property held for the mandator and to immediately transfer it to him or as he may instruct, saving such rights to the payment of outstanding dues and expenses according to law.

(6) Notwithstanding the provisions of Article 1871 (1), in cases where a mandatory, as referred to above, brings, by any means, to the attention of any third party that he is acting in such capacity, the mandatory shall not be personally liable for the obligations entered into other than with and to the extent of the property held by him.

**Article 1872** states that the provisions of this Code shall not affect the provisions of the Commercial Code, or of any other special law or other usages of trade.

**Article 1873** states that: (1) A mandatory is bound to carry out the mandate so long as he is vested therewith, and in case of non-performance he is answerable for damages and interest.

(2) He is also bound to conclude any matter, which he may have commenced before the death of the mandator, if delay might be prejudicial.

**Article 1874** states that: (1) A mandatory is answerable not only for fraud, but also for negligence in carrying out the mandate.

(2) Nevertheless, such liability in respect of negligence is enforced less rigorously against a person whose mandate is gratuitous than against one receiving a remuneration.

**Article 1875** states that the mandatary, unless expressly exempted by the mandator, is bound to render to the latter an account of his management and of everything he has received by virtue of the mandate, even if what he has received was not due to the mandator.

**Article 1876** states that: (1) The mandatary cannot substitute another person for himself, if he has not been empowered to do so by the mandator.

(2) If such power has been conferred upon him but without naming the person to be substituted, the mandatary is answerable for the person he has substituted if he has selected a person notoriously incompetent or insolvent or whom he otherwise knew to be such.

(3) In all cases, the mandator may act directly against the person whom the mandatary has substituted.

**Article 1877** states that: (1) Where there are several attorneys or mandataries appointed by the same instrument, there is no joint and several liability between them, unless it be expressly so agreed.

(2) Each of such mandataries may validly carry out the mandate independently of the consent of the other mandataries or notwithstanding their opposition, unless the mandator has expressly ordered that one shall not act without the other, or has otherwise expressly specified their duties.

(3) The limitation of powers of each of the aforesaid mandataries may not be set up against third parties, unless such limitation appears from the instrument of procuration, or unless it is shown that such third parties have otherwise had sufficient knowledge of such limitation.

**Article 1878** states that a mandatary owes interest on the sums which, without the authority of the mandator, he has applied to his own use, from the day on which he has made such use, and on any other sum in which he shall remain debtor, from the day on which he is put in default, saving, in both the aforesaid cases, the usages of trade.

**Article 1879** states that a mandatary who has given to the party with whom he has contracted in such capacity sufficient information as to his powers, is not liable for any warranty in respect of what he has done beyond such powers, unless he has personally bound himself thereto.

**Article 1880** states that: (1) A mandator is bound to carry out the obligations contracted by the mandatary in accordance with the powers which he has given him.

(2) He is not liable for what the mandatary has done beyond such powers, unless he has expressly or tacitly ratified it.

**Article 1881** states that: (1) The mandator must repay to the mandatary the advances and expenses made or incurred by him in carrying out the mandate; and he must pay him the remuneration if promised to him, or if it is presumed to have been tacitly agreed upon, regard being had to the profession of the mandatary and to other circumstances.

(2) If no negligence be imputable to the mandatary, the mandator cannot refuse to make such reimbursement and payment, even though the matter has not been successful; nor can he have the amount of such expenses and advances bona fide incurred or made, reduced, on the ground that they might have been less.

**Article 1882** states that the mandator must also indemnify the mandatary for the losses he has sustained by reason of the mandate, where no negligence is imputable to him.

**Article 1883** states that interest is due by the mandator to the mandatary on the advances and expenses mentioned in Article 1881 from the day of the payment of such sums.

**Article 1884** states that where the mandatary has been appointed by several persons for a common business, each of them is jointly and severally liable towards him for all the consequences resulting from the mandate.

**Article 1885** states that the mandatary shall have the right of retention, so long as he is not paid what is due to him in consequence of the mandate

**Article 1886** states that: (1) Mandate is terminated -

(a) by the revocation of the procuration;

(b) by the death, the interdiction or the incapacitation, whether general or special, from entering into contracts, the declaration of bankruptcy, or the cession bonorum either of the mandator or of the mandatary;

(c) by the termination of the powers of the mandator;

(d) by the expiration of the time during which the mandate was to continue;

(e) by the renunciation on the part of the mandatary:

Provided that:

(i) in the case of the termination of a mandate in which the mandatary, being a physical person, has been empowered to transfer immovable property on behalf of the mandator or where the mandate is one of a general nature given between physical persons, such termination may be notified by the mandator or by any other person having an interest in the mandate to the Chief Notary to Government who will enter the particulars of such termination in a register held by him for the purpose and which shall be accessible to the public during office hours; and

(ii) the Minister responsible for Justice shall have the power to issue regulations to establish an electronic register where the registration of mandates and their termination may be made and to establish such formalities, fees and applicable procedures for registration in the said electronic register and to regulate access to the said register.

(2) An irrevocable mandate by way of security shall not terminate upon the events stated in sub-Article (1) and shall continue to be binding on, or continue for the benefit of, the heirs or liquidator (or similar officer) of the mandator, or of the mandatary, or the creditor if a different person, in accordance with its terms. Neither shall such an irrevocable mandate terminate on

such events when they occur in relation to a mandatary who is a different person than the creditor in whose favour the mandate has been granted.

(3) The creditor whose interests are secured through the mandate, or his heirs, or liquidator (or similar officer), may appoint a substitute to act as mandatary, including himself, or may apply to the Court of voluntary jurisdiction to make such appointment.

**Article 1887** states that: (1) The mandator may revoke the mandate whenever he chooses, unless the mandate is expressly stated to be granted by way of security in favour of the mandatary or of any other person, and that it is irrevocable, in which case it may only be revoked with the consent of the person whose interest is secured thereby. The mandatary under such an irrevocable mandate granted by way of security, shall be bound to act in a fair and reasonable manner when exercising the powers granted thereunder, provided that a mandate by way of security which is irrevocable may only be granted when the object to which it relates is property which is movable, by nature or by operation of law, and it shall not be permissible for such a mandate to be issued with reference to immovable property or rights therein.

(2) Where powers are exercised under an irrevocable mandate granted as stated above and form part of or are granted pursuant to or in the context of a written agreement governing a broader relationship, the mandatary shall furthermore be bound to exercise such powers in accordance with the terms and subject to the conditions of such agreement.

(3) Except as provided in the preceding sub-Article, the appointment of a new mandatary for the same business is equivalent to a revocation of the mandate given to the previous one, even though the new mandatary does not accept the mandate.

(4) A general mandate does not produce the revocation of a special mandate previously given, unless the business contemplated in the special mandate is expressly included in the general mandate.

**Article 1888** states that: (1) The existence of any of the causes for which a mandate is terminated cannot be set up against third parties who, having no knowledge of such cause, have contracted with the mandatary; saving the right of the mandator to seek relief against the mandatary, where competent.

(2) Nor may the existence of any such cause be set up against the mandatary, if at the time of acting he also had no knowledge thereof.

**Article 1889** states that: (1) A mandatary may renounce the mandate by giving notice of his renunciation to the mandator.

(2) Nevertheless, if the renunciation is prejudicial to the mandator, he must be compensated by the mandatary, unless it is impossible for the latter to continue to carry out the mandate without suffering himself considerable prejudice.

**Article 1890** states that in case of the death of the mandatary, his heirs must, if they know that he was a mandatary, give notice thereof to the mandator, and attend, in the meantime, to what is required in the interest of the latter, as circumstances may demand.

*Code of Organisation and Civil Procedure, Chapter 12 of the Laws of Malta*

**Article 2** states that:

(1) The courts of justice of civil jurisdiction for Malta are either superior or inferior. Each court may be divided into different sections.

(2) Unless otherwise established by law, the President of Malta may by Order establish the sections of each Court, and designate the categories of cases assigned to each section; and may by subsequent Order amend, revoke or substitute such Order.

(3) Saving any other provision of law, the courts of justice of civil jurisdiction are exclusively vested with the judicial authority in civil matters within the jurisdiction of the tribunals of Malta.

*Small Claims Tribunal Act, Chapter 380 of the Laws of Malta*

**Article 3 (2)** states that:

(2) Subject to subarticle (5), the Small Claims Tribunal shall have jurisdiction to hear and determine only all money claims of an amount not exceeding five thousand euro (€5,000): Provided that, in determining the sum referred to in this subarticle, no account shall be taken of fees and costs relative to the same claim.

**English Statute Law**

*Companies Act 1948*

**Article 124 (4)** states that a director and officer shall include any person in accordance with those directions or instructions the directors of the company are accustomed to act.

Article 190 states that: (i) It shall not be lawful for a company to make a Prohibition loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person: Provided that nothing in this section shall apply either –

(a) to anything done by a company which is for the time being an exempt private company; or

(b) to anything done by a subsidiary, where the director is its holding company; or

(c) subject to the next following subsection, to anything done to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; or

(d) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business.

(2) Proviso(c) to the foregoing subsection shall not authorise the making of any loan, or the entering into any guarantee, or the provision of any security, except either –

(a) with the prior approval of the company given at a general meeting at which the purposes of the expenditure and the amount of the loan or the extent of the guarantee or security, as the case may be, are disclosed; or

(b) on condition that, if the approval of the company is not given as aforesaid at or before the next following annual general meeting, the loan shall be repaid or the liability under the guarantee or security shall be discharged, as the case may be, within six months from the conclusion of that meeting.

(3) Where the approval of the company is not given as required by any such condition, the directors authorising the making of the loan, or the entering into the guarantee, or the provision of the security, shall be jointly and severally liable to indemnify the company against any loss arising therefrom.

**Section 199 (i)** states that subject to the provisions of this section, it shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company.

#### ***Companies Act 1985***

**Section 1 (2) (a)** states that a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them ('a company limited by shares').

**Section 317 (1)** states that it is the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company'.

**Section 330** states that: (1) The prohibitions listed below in this section are subject to the exceptions in sections 332 to 338.

(2) A company shall not-

- (a) make a loan to a director of the company or of its holding company;
- (b) enter into any guarantee or provide any security in connection with a loan made by any person to such a director.

(3) A relevant company shall not-

- (a) make a quasi-loan to a director of the company or of its holding company;
- (b) make a loan or a quasi-loan to a person connected with such a director;
- (c) enter into a guarantee or provide any security in connection with a loan or quasi-loan made by any other person such a director or a person so connected.

(4) A relevant company shall not-

- (a) enter into a credit transaction as creditor for such a director or a person so connected;
- (b) enter into any guarantee or provide any security in connection with a credit transaction made by any other person for such a director or a person so connected.

(5) For purposes of sections 330 to 346, a shadow director is treated as a director.

(6) A company shall not arrange for its assignment to it, or the assumption by it, of any rights, obligations or liabilities under a transaction which, if it had been entered into by the company, would have contravened subsections(2),(3), or(4); but for the purposes of sections 330 to 347 the transaction is to be treated as having been entered into on the date of the arrangement.

(7) A company shall not take part in any arrangement in which-

- (a) another person enters into a transaction which, if it had been entered into by the company, would have contravened any of subsections(2),(3),(4), or(6); and

(b) that other person, in pursuance of the arrangement, has obtained or is to obtain any benefit from the company or its holding company or a subsidiary of its company or its holding company.

### ***Companies Act 2006***

**Section 170** states that: (1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company.

(2) A person who ceases to be a director continues to be subject –(a) to the duty in Section 175(duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and(b) to the duty in Section 176(duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director. To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.

(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

(5) The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

**Section 171** states that a director of a company must –(a) act in accordance with the company’s constitution, and(b) only exercise powers for the purposes for which they are conferred.

**Section 172** states that: (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard(amongst other matters) to –

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company’s employees,
- (c) the need to foster the company’s business relationships with suppliers, customers and others,
- (d) the impact of the company’s operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection(1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

**Section 173** states that: (1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting –(a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or(b) in a way authorised by the company’s constitution.

**Section 174** states that: (1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with –(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has.

**Section 175** states that: (1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.

(4) This duty is not infringed –(a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or(b) if the matter has been authorised by the directors.

(5) Authorisation may be given by the directors –(a) where the company is a private company and nothing in the company’s constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or(b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.

(6) The authorisation is effective only if –(a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and(b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

(7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

**Section 176** states that: (1) A director of a company must not accept a benefit from a third party conferred by reason of –(a) his being a director, or(b) his doing(or not doing) anything as director.

(2) A ‘third party’ means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.

(3) Benefits received by a director from a person by whom his services(as a director or otherwise) are provided to the company are not regarded as conferred by a third party.

(4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

(5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

**Section 177** states that: (1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.

(2) The declaration may (but need not) be made –(a) at a meeting of the directors, or (b) by notice to the directors in accordance with –(i) Section 184 (notice in writing), or (ii) Section 185 (general notice).

(3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.

(4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.

(5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question. For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.

(6) A director need not declare an interest –(a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest; (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered –(i) by a meeting of the directors, or (ii) by a committee of the directors appointed for the purpose under the company's constitution.

## **Italian Statute Law**

### *Codice di Commercio 1865*

**Article 122** states that the administrators are responsible for the execution of the mandate and for any other obligation that the law imposes upon them, but cannot do any other thing that goes beyond what is mentioned in the contract of formation, and in which case they shall be personally liable towards the company and third parties.

**Article 129** states that a company shall be managed by directors who shall be appointed for a definite period of time and whose position may be revoked and who may be even shareholders, at a payment or gratuitously.

**Article 130** states that that the directors shall not be held liable for the acts done in the name of the company.

### *Codice di Commercio 1882*

**Article 121** states that a company shall be managed by one or more mandataries who may also be shareholders and who shall be appointed for a temporary period of time and shall be revoked.

**Article 122** states that the administrators cannot be held liable for any acts done in the name of the company.

**Article 130** asserts that the directors are responsible for the execution of the mandate that they are entrusted with, and for any other obligation that is imposed upon them by law.

### *Codice Civile 1865*

**Articles 1737 up to 1763**, in essence, are reproduced in the Maltese civil code under the mandate section. Accordingly, the French mandate provisions are not again reproduced in English. The Maltese mandate provisions which however include more liabilities or duties than their Italian counterparts do arise under Articles 1859, 1860, 1862, 1863, 1864A, 1866, 1871A and there are also some differences carried out to 1886.

### *Codice Civile 1942*

**Article 2392** states that directors are responsible towards the company as its mandataries.

**Article 2476** lays down that directors are responsible towards the company for any damages that arise out of their inobservance of duties imposed by law and by the memorandum and articles of association of the company.

### **French Statute Law**

#### *Code Civil 1804*

**Articles 1984 up to 2010**, in essence, are reproduced in the Maltese civil code under the mandate section. Accordingly, the French mandate provisions are not again reproduced in English. The Maltese mandate provisions which however include more liabilities or duties than their French counterparts do arise under Articles 1859, 1860, 1864A, 1866, 1871A and some changes to 1886.

*Code de Commerce 1807*

**Article 18** states that contracts that regulate companies shall be governed by the civil law, by the commercial law and by any agreement between the parties.

**Article 29** states that an anonymous company enjoys a separate legal personality from its shareholders.

**Article 30** states that an anonymous company is designed to carry out an object.

**Article 31** that a company shall be administered by mandataries, who shall be elected for a definite period of time, who may also be shareholders, either for payment or gratuitously.

**Article 32** that the directors are only responsible for the execution of the mandate that they are trusted with.