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Демонстрационный вариант и методические рекомендации по направлению «Юриспруденция»

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ДЕМОНСТРАЦИОННЫЙ ВАРИАНТ

Время выполнения задания - 180 мин.

Предварительные критерии оценивания работ участников олимпиадных состязаний
Оценивание выполненных заданий осуществляется по 100-бальной шкале. Анализ статьи – 50 баллов; правильное решение задачи - 50 баллов.

1) **Прочитайте статью* и сделайте ее критический анализ на русском языке.**

*J. Payne. Legal Capital in the UK Following the Companies Act 2006// In J. Armour & J. Payne (eds), Rationality in Company Law: Essays in Honour of D D Prentice (Hart Publishing, 2008)

1. Introduction

The rules governing legal capital have been under review recently both in the UK and in Europe.[1] The primary purpose of these rules is to regulate the conflict that exists between creditors and shareholders regarding how to allocate a company's capital. This conflict is obvious once the company is insolvent, at which point the company has insufficient money to meet all its financial obligations. However, UK company law has also regulated the conflict by imposing legal capital rules during a company's solvency. The form of this regulation has been the imposition of various rules constraining corporate activity by reference to the shareholders' capital investment, in order to protect creditor interests. The efficacy and desirability of these legal capital rules is questionable.

2. The function of legal capital rules

It is well understood that the interests of those who contribute to a company's cash flow will come into conflict. The most obvious conflict is that between the creditors and the shareholders of a company, although of course others can exist, not least between classes of shareholders, and between different creditors.[2] The primary rationale of the legal capital rules is the regulation of this conflict between shareholders and creditors, and the purpose of these rules has been to resolve the conflict in favour of the creditors.[3]

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[1] In the UK the Company Law Review reviewed the legal capital rules: *The Strategic Framework*,February 1999 (URN 99/654); *Company Formation and Capital Maintenance* (URN 99/1145);*Developing the Framework* (URN 00/656); *Completing the Structure* (URN 00/1335); *Final Report*(URN 01/942 and URN 01/943). This was followed by a number of White Papers (see esp *Modernising Company Law* (Cm 5553-I and 5553-II), July 2002, and White Paper, March 2005 (Cmnd6456)) and then the Companies Act 2006. In Europe, see European Commission, *Simpler Legislation for the Single Market (SLIM): Extension to a Fourth Phase*, SEC (1998) 1944, Brussels, 16 November1998; High Level Group of Company Law Experts (*Report on a Modern Regulatory Framework for Company Law in Europe*, Brussels, 4 November 2002).

[2] Disputes between creditors arise most acutely on insolvency, as a result of their respective priorities. Adjusting creditors ie those in a position to alter the terms on which they lend may be able to improve their position (pre-insolvency) by taking security or by other contractual means, but the law will also operate to regulate these conflicts (see eg the ring-fenced fund: Insolvency Act 1986, s 176A). The terminology of adjusting and non-adjusting creditors is derived from L A Bebchuk and J M Fried, "The Uneasy Case for the Priority of Secured Claims in Bankruptcy" (1996) 105 Yale LJ 857, 881-890.

[3] Some of the legal capital rules, such as pre-emption rights (Companies Act 1985, ss 89-95, Companies Act 2006, ss 561-573) can be seen as a device to protect shareholders. Other rules have been said to have a role in protecting market integrity (the rules restricting share repurchases have been said to have this role: *The Purchase By a*

Whilst a company is solvent the shareholders generally control the operation of a company, directly through the general meeting and indirectly through the directors. They are in a position to benefit themselves at the expense of the creditors in a number of ways.[4] They can make distributions to themselves, such as dividend payments and share buy-backs, thereby reducing the equity "cushion" available to repay creditors (asset diversion). They can manipulate the investment profile of the company in a way which disadvantages creditors, for example by taking on riskier projects than the creditors contemplated when they extended credit to the company (risk shifting), or by abandoning projects with a net positive value if the only benefit attaches to the creditors (underinvestment).[5] They may also disadvantage the existing creditors of a company by issuing additional debt of the same or higher priority (claim dilution).[6] Of course, creditors can also engage in behaviour which advantages themselves at the expense of the shareholders.[7] However, most creditors will not have the control necessary to enable these measures to be implemented.[8] Even those in a position to negotiate such terms are unlikely to engage in this type of interventionist approach, since covenants incorporated into debt contracts constraining the actions of internal controllers can be costly due to the restrictions they place on the company's flexibility[9] and there is always a danger that the imposition of overly intrusive covenants might lead the creditor to be labelled as a shadow director.[10] Therefore, although it is common for a sub-set of adjusting lenders to insert covenants relating to minimum net worth, interest cover and gearing, creditors do not generally get involved in the detailed decision making of companies.

The US and Europe have traditionally adopted quite different responses to the potential conflict between creditors and shareholders regarding the allocation of a company's legal capital. In the US the legal capital rules have evolved to provide maximum flexibility to shareholders, and creditor protection devices are noticeable largely by their absence in some State corporate laws.[11] In the US, some creditor protection is provided by the Federal "fraudulent transfer laws"[12] but the primary tool available to creditors who wish to protect themselves from opportunistic shareholders is contract.

Company of its own shares – A Consultative Document, Cmnd 7944 (HMSO, London, 1980). However, the primary rationale behind the legal capital rules is creditor protection (see eg CLR, *The Strategic Framework*, February 1999 (URN 99/654), 81).

[4] C W Smith & J B Warner "On Financial Contracting: An Analysis of Bond Covenants" (1979) 7 J Fin Econ 117, 118-119.

[5] S C Myers, "Determinants of Corporate Borrowing" (1977) Journal of Financial Economics 147.

[6] This could result in a benefit to shareholders if the directors use the borrowed money to invest in risky projects that benefit shareholders at the expense of creditors: Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3 Journal of Financial Economics 305.

[7] Eg requiring the company to repay loans early or requiring it to decline to pay a dividend, or encouraging the company to invest in projects which are less risky than originally envisaged when the creditors invested or not to invest in projects likely to accrue benefits only for the shareholders.

[8] Only adjusting creditors (see fn 3) will be in a position to negotiate such terms, and only a sub-set of these, most notably the banks, will have the power to negotiate this type of provision.

[9] C W Smith & J B Warner "On Financial Contracting: An Analysis of Bond Covenants" (1979) 7 Journal of Financial Economics 117. Many studies have concluded that the type of covenants included in loan agreements does affect the pricing of debt eg M Bradley and M R Roberts, "Are Bond Covenants Priced?" http://repec.org/esNASM04/up.21166.1069857472.pdf

[10] Merely acting within the usual creditor-debtor relationship is unlikely to render a creditor as a shadow director (eg Lewison J in *Ultraframe Ltd v Fielding* [2005] EWHC 1638: "In my judgment, where an alleged shadow director is also a creditor of the company, he is entitled to protect his own interests as creditor without necessarily becoming a shadow director" at [1267]). There has to be proof of a pattern of conduct in which the de jure directors of the company were accustomed to act on the instructions or directions of the alleged shadow director: *Secretary of State for Trade and Industry v Deverell* [2000] 2 BCLC 133. Intervening in the investment decisions of the company on a regular basis may, however, be enough to label a creditor a shadow director.

[11] L Enriques and J R Macey "Creditors versus capital formation: The case against the European Legal Capital rules" (2001) 86 Cornell Law Review 1165.

[12] R C Clarke, "The Duties of the Corporate Debtor to its creditors" (1977) 90 Harvard Law Review 505. In the UK the equivalent provisions are ss 238, 423 Insolvency Act 1986.

By contrast, the European model, on which the UK model depends heavily because of the need to implement the Second Company law directive, has regarded the threat to creditors as real and credible. On this view the shareholders obtain the benefit of limited liability when they invest in a company, but this comes at a cost to the creditors. In the UK common law exceptions to the principle of limited liability are rare and, where they do exist, very narrowly constrained.[13] The principal statutory exception, section 214 of the Insolvency Act 1986, is powerful in theory,[14] but difficulties with the funding of these actions in the past has meant that this section has rarely been invoked in practice.[15] So the principle of limited liability is very much intact.

Undoubtedly this principle constrains the amount available to creditors on insolvency. In Europe this has resulted in the view that creditors need to be compensated and that this should be provided by law rather than being left to contract. The form of this compensation has been rules that constrain corporate activity by reference to the shareholders' capital investment, principally by prescribing a minimum level of capital to be invested in a company by the shareholders and a restriction on transfers to shareholders in some circumstances. The point is that creditors rank ahead of shareholders in a winding up and the purpose of the capital maintenance rules is to ensure that shareholders don't undermine that principle by improperly distributing assets to themselves, not only once the company is insolvent, but also while the company remains solvent.

It is interesting that of the various potential dangers which shareholders pose to creditors, namely asset diversion, altering the investment profile of the firm, or claim dilution by issuing additional debt, the focus of the Second Directive, and UK company law, has been on preventing the first. Both concentrate on creating and maintaining an equity cushion to protect the creditors in the event of insolvency, and one of the key factors in that approach has been the prevention of capital return to the shareholders. A rules-based approach[16] has been adopted to regulate this issue. It may be that the focus of the Second Directive, and UK company law, on asset diversion is unsurprising. The idea of capital as a fund available to meet creditors' claims, is well-embedded. It is seen as the compensation for limited liability and a necessary corollary of this is that capital should not be paid back to the shareholders.

What is interesting to note is that of the three potential forms of abuse, asset diversion is one of the easier ones for the creditors, or at least the adjusting creditors, to monitor. By contrast, in relation to the potential abuse of altering the investment profile of the company to the creditors' disadvantage, a standards-based approach has been adopted. This has been regarded as a matter for the directors, and regulated primarily through the duties imposed on directors. In particular, directors are under an obligation to make investment decisions bona fide in the best

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[13] To say that there is no presumption in favour of lifting the veil at common law "may be regarded as an understatement": *Ord v Belhaven Pubs Ltd* [1998] 2 BCLC 447, 453 per Hobhouse LJ.

[14] D D Prentice and J Payne "Civil Liability for Directors in English Law" in I Ramsey (ed) *Company Directors' Liability for Insolvent Trading* (CCH Australia Ltd, Melbourne, 2000).

[15] Actions under s 214 Insolvency Act 1986 are brought by the liquidator and were traditionally funded from the pot of money available to pay the creditors. As a result a liquidator would not commence an action unless there is a strong prospect that the money recovered will exceed the expenses of the litigation. .However, from 2002 amendments to the Insolvency rules meant that office holder actions could be charged to liquidation expenses (Insolvency (Amendment)(No 2) Rules 2002, rule 23 which amended r 4.218). However, to date this change in the law has had little impact, perhaps because of the decision of the House of Lords in *Buchler v Talbot* [2004] UKHL 9, which provided that liquidation expenses, while taking priority over the claims of preferential and unsecured creditors, did not enjoy the same priority over the claims of the floating charge holders. However this decision is reversed by s 1282 of the Companies Act 2006 (in force from 6 April 2008). This may mean that we will see an increase in s 214 actions in the future, although this change does not alter the fact that directors of an insolvent companies may have little or no funds worth pursuing.

[16] This terminology is adopted in R R Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford, OUP, 2004).

interests of the company, an obligation that has been subjectively assessed by the courts to date.[17]

Where the company is solvent this has traditionally meant acting in the interests of the shareholders as a whole, and although section 172 of the Companies Act 2006 potentially alters this by adding a requirement that directors consider the interests of various other groups, such as employees and customers, when fulfilling this obligation the position of the company's creditors do not form part of this analysis. While the company is solvent the creditors' interests do not need to be separated from those of the shareholders. There is no conflict between the two at this point – broadly what is good for the shareholders will also be good for the creditors.[18] Only where the company is insolvent, or nearing insolvency, must the directors take account of the creditors' interests.[19] As regards the danger of claim dilution, it is largely left to creditors to protect themselves by contract where the company is solvent, by taking security and using negative pledge clauses to protect their priority. The Law Commission recently considered the priority rules in some detail and made a number of suggested reforms to this area,[20] but there was little enthusiasm for any reform of this topic from practitioners.[21] It was felt that the current system allows creditors to protect themselves adequately against this risk.

The vast majority of the UK's legal capital rules are now in statutory form, primarily the Companies Act 2006 which will shortly replace the Companies Act 1985.[22] These statutory provisions have their origins in rules applicable to all companies, which originate in the nineteenth century, principally by ay of caselaw, and in European legislation, principally the Second Company Law Directive,[23] which introduced legal capital rules for public companies. The Second Directive imposes limits on minimum capital, contributions, distributions to shareholders and increases or reductions of capital for public companies.[24] Many Member States went beyond the Second Directive's legal capital regime when implementing this Directive. The UK was one of the States that did so, extending many of the restrictions to private companies,[25] and gold-plating the regime in places.[26] The next section will assess whether the imposition of these legal capital rules is justifiable.

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[17] *Re Smith & Fawcett Ltd* [1942] Ch 304, 306 per Lord Greene. Cf Companies Act 2006, s 172 which puts this obligation on a statutory footing. Section 172(1) provides that "A director of a company must act in the way he considers, in good faith…" (ie a subjective assessment) but goes on to provide "and in doing so have regard (amongst other matters) to…" which introduces an objective requirement into the exercise of the directors' duties.

[18] The payment of dividends may be seen as an exception to this principle.

[19] *Winkworth v Edward Baron* [1987] 1 All ER 114; *West Mercia SafetywearLtd v Dodd* [1998] BCLC 250. This duty is embedded into the Companies Act 2006 by s 172(3).

[20] Law Commission, *Company Security Interests* (Law Com No 296, Cmnd 6654, August 2005).

[21] See eg Comments of the Financial Law Committee of the City of London Law Society on the DTI's consultation document, *The Registration of Companies' Security Interests (Company Charges)* of July 2005, 31 August 2005, 1-2.

[22] The longstop date for full implementation of the Companies Act 2006 is 1 October 2009 and many of the legal capital measures are only scheduled for implementation on that date, although some (eg the provisions relating to distributions and minimum capital requirements) will be brought into force on 6 April 2008. For the full implementation schedule see www.berr.gov.uk/files/file 42847.doc.

[23] Second Council Directive 77/91 [1977] OJ L26/1.

[24] It also creates other constraints for public companies, which arguably have little or no valid creditor protection role at all, such as the ban on financial assistance. According to Eilis Ferran, financial assistance rules are better regarded as an "offshoot" of the legal capital rules: E Ferran, 'The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union' (2006) 3 European Company and Financial Law Review 178.

[25] Often although the Companies Act 1985 applied provisions from the Second Directive to private companies, there were relaxations in the way in which the regime operated eg the financial assistance rules applied to private companies (ss 151-153 Companies Act 1985) but a whitewash procedure was put in place for private companies (ss 155-158). The ban on providing financial assistance for the purchase of a company's own shares is removed by Companies Act 2006 for private companies, but is left in place for public companies (see Companies Act 2006, ss 677-682).

[26] For example, the definition of capital for the purposes of the Companies Act 1985 includes share premiums and any capital redemption reserve although this is not required by the Second Directive:

3. Objections to the legal capital rules

A number of objections can be made to the legal capital rules.

(i) Creditor protection via the legal capital regime introduced by the Second Directive.

A significant objection to the legal capital regime is that it does not successfully perform its function of protecting creditors, and indeed that the regime imposes costs on both the company and its creditors. The regime in place at the time of writing remains that based on the Second Directive and the Companies Act 1985. This regime will soon be replaced in the UK by the Companies Act 2006. The implementation date for most of the legal capital provisions in the 2006 Act is 1 October 2009.[27] This section will assess the effectiveness of the legal capital provisions in the Second Directive, as implemented by the 1985 Act, in terms of providing creditor protection. The next section of this paper will assess whether the 2006 Act offers any significant improvement on this position.

If the idea behind the legal capital rules is to provide the creditors with the comfort of a guaranteed equity "cushion" then the provisions in the Second Directive are ineffective. The Second Directive adopts a "one size fits all" approach which does not take account of the size of the debt which the company may incur or the riskiness of its activities. In addition, the minimum capital requirement for public companies contained in the Second Directive, €25,000, is miniscule compared to the size of the debts of most public companies. The Companies Act 1985 gold plated this requirement to some extent, implementing a figure of £50,000 [28] but this adds no significant element of protection for creditors. It is notable that the 1985 Act imposes no minimum capital requirement for private companies, which are just as likely to have creditors (both voluntary and involuntary) potentially in need of protection.

As regards the consideration received for shares, the regime utilises the concept of par value by which to measure the adequacy of the consideration received, a concept that bears no relation to the market price of the shares. Indeed in this scheme it is entirely lawful for a company to issue shares below market price.[29] On one view this issue is of little relevance or interest to the creditors at all. In a case like *Ooregum Gold Mining Co v Roper*[30] where the shares are allotted at 75 per cent of the par value, since the shares were then trading at a discount to the market price, it is difficult to see why this impacts on creditors in any negative way since any money inputed to the company by the shareholders expands the potential pool of assets for creditors, even if issued at below the par value of the shares.[31] There is clearly a potential issue for the shareholders in such circumstances, but if the consideration for the shares reflects the market price, as it did in *Ooregum*, it is difficult to see how the shareholders are prejudiced, especially if pre-emption rights allow them to participate in the issue.

The Second Directive specifies how non-cash consideration received by public companies should be valued.[32] Serious doubt can be cast on the utility of those valuation rules.

Companies Act 1985, ss 130(3), 170(4) (see, now, Companies Act 2006 ss 610(4) and 733(5)(6)).

[27] Some of the legal capital measures have an earlier implementation date of 6 April 2008 (see www.berr.gov.uk/files/file42847.doc for the full details).

[28] Where minimum capital levels are set at a higher rate this seems to have an adverse effect on entrepreneurship: J Armour and D Cumming, "Bankruptcy Law and Entrepreneurship" CBR Working Paper 300, June 2005, available at http://ssrn.com/abstract=762144.

[29] *Hilder v Dexter* [1902] AC 474, 480, although this may be a breach of directors' duties (*Shearer v Bercain Ltd* [1980] 3 All ER 295).

[30] [1892] AC 125.

[31] This argument may have had less weight in earlier stages of the company's development when mandatory accounting disclosures didn't exist and creditors might have had little information other than par value to rely on. At that point future creditors of the company could potentially have been prejudiced if they relied on the par value as a measure of the capital actually subscribed. It is difficult to imagine that any creditors, present or future would rely on par value in this way nowadays.

[32] As regards the assessment of non-cash consideration for private companies, this is not dealt with by statute, but by the common law: the courts will not investigate the adequacy of non-cash consideration received unless it is manifestly colourable or fraudulent: *Re Wragg* [1897] 1 Ch 796, 830; *Hong Kong*

All that the rules aim to guarantee is that the value of the item on receipt was equal to the par value of the shares at that moment in time. For many items this will bear little relation to the value as and when the creditors seek to realize their debts in the future.[33] In fact these valuation rules are costly for companies both in money, in that the independent reports need to be paid for, and in time, as they delay company formation and increases in capital through the issue of new shares.

The prohibition on issuing shares in exchange for future services contained in the Second Directive is also problematic in the context of the financing of high tech startup companies. If creditors do wish to rely on a company's equity cushion they need to examine a company's entire balance sheet, and in particular the current value of the firm's assets, rather than the value of the assets at the moment of purchase.

While the capital maintenance rules within the Second Directive appear to offer more protection to creditors, since they aim to restrict distributions to shareholders and reductions of capital, in reality little, if any, protection is actually afforded by these rules. There are two primary reasons for this failure. First, the Second Directive regulates distributions to shareholders by imposing a balance sheet test.[34] However, this balance-sheet information bears little relation to the company's true financial position.[35] It is calibrated by reference to historic contributions by shareholders, rather than by any calculation of the company's assets or financial needs on a going concern basis.[36] Second, the distribution rules comprise only a narrow set of circumstances in which money cannot be returned to the shareholders.[37] They do not prevent assets being distributed to shareholders in other ways, such as the payment of excessive compensation for shareholders who are also directors of the company. In the UK directors of private companies can avoid the rules preventing the payment of dividends out of capital by returning capital to the shareholders by means of a share repurchase, providing the directors declare that the company will remain solvent for twelve months.[38] Neither do the capital maintenance rules prevent the assets being lost in other ways, eg through poor investments taken by directors, fraud by directors or just unfortunate market conditions.[39]

These rules also impose burdens on companies. In relation to a reduction of capital, for example, the need to go to court, and for the court to have regard to the creditors' interests,[40] is a

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Gas Co v Glen [1914] 1 Ch 527.

[33] Many assets devalue quickly (eg computers) and may have no value at a later date. In addition the "independent" experts in this regard are repeat players in the market and will not wish to lose current or prospective clients by acting too independently in this regard. So long as the assets are not outrageously over-valued, it is likely that the non-cash consideration will be approved.

[34] Second Directive, art 15(1)(a) and see Companies Act 1985, s 263 (Companies Act 2006, s 830).

[35] Enriques & Macey, 1190 (supra n11); J Rickford ed, "Reforming Capital: Report of the Interdisciplinary Group on Capital Maintenance (2004) 15 EBLR 919.

[36] Section 264 Companies Act 1985 (s 831 of the Companies Act 2006) comes closer to a new asset test in relation to public companies.

[37] It can be argued that this is a situation that particularly merits intervention (J Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' (2000) 63 MLR 355) since dividends may be seen as harming only creditors whereas other kinds of losses (arising eg through poor investment decisions or unfortunate market conditions) harm shareholders too (see n 20).

[38] Companies Act 1985, ss 171-177 (see Companies Act 2006, Part 19, Ch 5).

[39] In the UK there is no rule which requires the company to maintain a particular level of capital. Companies Act 1985, s 142 (implementing Art 17 of the Second Directive) merely requires the directors to call a meeting where a serious loss of capital occurs. This is restated as Companies Act 2006, s 656. This rule is only likely to be invoked in extreme financial distress, when the shareholders' investment in the company has already been substantially depleted, and therefore it offers little additional creditor protection. This may be contrasted with some other European countries which have a rule of this kind in place. For instance, if the net assets of a Swedish company fall below half its share capital, then the shareholders must either inject fresh equity to restore the new asset level, or liquidate the company (see J Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' (2000) 63 MLR 355, 371).

[40] This is an obligation imposed by the Companies Act 1985 on both public and private companies: Companies Act 1985, ss 135-141.

costly exercise, while the amount of protection afforded to creditors in a situation where the company is undeniably solvent, is minimal. The evidence that the creditors' interests are protected is usually demonstrated by the company providing the court with evidence of a bank guarantee for all existing debts. The rules banning public companies from providing assistance in the purchase of their own shares[41] are burdensome, costly and difficult to justify as a creditor protection device.[42] The Companies Act 1985 is particularly problematic in this regard as it gold-plated the Second Directive on implementation, extending this restriction to private companies, albeit with the possibility of a whitewash procedure.[43]

The legal capital rules also impose other costs on companies. For example, costs sometimes arise because transactions have to be ingeniously structured so as to avoid a particular legal capital rule, such as the ban on companies providing financial assistance for the acquisition of their own shares.[44] The legal capital rules rarely prevent transactions altogether.[45]There are generally ways around the rules although these often require expensive legal advice, and may require court orders,[46] and are therefore costly in terms of both time and money. Alternatively the costs may arise as a result of the lack of flexibility that the legal capital rules engender. For example, the rules excluding undertakings to perform services as an acceptable form of consideration for shares may hinder start up companies, since they impose restrictions on the financing of those firms.[47]

(ii) Creditor protection via contract

In light of the apparent failure of the legal capital regime to provide meaningful creditor protection, a failure acknowledged by a wide range of academics and legislators and even accepted by the ECJ, at least as regards minimum capital requirements,[48] alternatives to the current regime need to be investigated. One suggested alternative approach is that adopted by many US states, namely that the law need not and should not regulate this issue and that to the extent that creditors require protection this can be provided via contract. On this view, there is no need for any protection to be provided to the creditors beyond what they might be able to bargain for themselves. To the extent that there is a danger of abuse by the shareholders,[49] the adjusting creditors have the opportunity to protect their own interests, by building in adequate interest rates to take account of the risk of lending, by taking some form of control rights over the company to monitor the directors' behaviour, and by taking security to protect themselves in the event of insolvency.

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[41] Second Directive, art 23.

[42] The prohibition "can only endanger the interests of creditors in a situation of potential insolvency, when the directors' duties and the provisions on fraudulent and wrongful trading are likely to be relevant": CLR, *Company Formation and Capital Maintenance* (URN 99/1145), 39.

[43] Companies Act 1985, ss 155-158.

[44] Financial assistance rules are best seen as an "offshoot" of the legal capital rules as they have only a limited overlap with the idea that a company should maintain its capital.

[45] L Enriques, "EC Company Law Directives and Regulations: How Trivial are They?" in J Armour and J A McCahery (eds) *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Oxford, Hart Publishing, 2006). As Enriques points out, even though the ban on financial assistance is often said to be an impediment to leveraged buy-outs, it has not prevented the development of a significant European LBO market.

[46]Eg companies can sidestep the distribution rules by means of a court-approved reduction of capital.

[47] Enriques and Macey, (supra n 11) 1195-6.

[48] *Centros Ltd v Erhvervs-og Selskabsstyrelsen* Case C-212/97.

[49] It is questionable whether the dangers of shareholder abuse on which these rules are predicated are as acute as is supposed. Companies who engage in behaviour which systematically harms creditors are soon going to find that future creditors will refuse to extend credit to the company at competitive rates. This particularly applies to the danger of asset diversion since this form of shareholder abuse is the most detectable by creditors. Borrowing is a repeat game for companies. Although only a subset of creditors will be able to adjust their behaviour in this way, these adjusting creditors are likely to be the most crucial to a company's future financial success.

One argument against this approach is that the legal rules mimic what can be achieved through contractual bargaining and that, because they provide a ready made solution, they reduce transaction costs. However, there seems little evidence for this in practice,[50] and even if there were, this does not present a compelling argument for retaining them as mandatory rather than optional rules.[51] As Eilis Ferran points out "[a] justification for legal capital rules that is based on their function as a transaction cost-reducing mechanism is only plausible where the market participants are allowed the flexibility to choose between the ready-made model provided by the law or a contractual model that may cost more to negotiate but which may be cheaper in the long run because of lower interest charges or otherwise more favourable financing terms."[52] Contract–based systems have a flexibility and adaptability which is hard, if not impossible, to mimic in a statutory model. It is difficult to see why official lawmakers are in a better position to supply the terms for debt instruments than the users of such instruments in practice, and if standard terms are needed it seems sensible to leave it to the market participants themselves to generate.

One further argument that is sometimes raised against the proposition that creditor protection can be left to contract is the fact that only some creditors are in a contractual relationship with the company and of those only a sub-set will have the incentive, bargaining power and resources necessary to improve their position by taking security or by other contractual means. However, even those that do not have the opportunity or ability to adjust, such as trade creditors and involuntary creditors, may be able to free ride on the covenants imposed by more sophisticated creditors.[53] This may not always work perfectly in practice and the benefits to weaker creditors

will only arise where the contractual negotiation or creditor monitoring processes of the adjusting creditors works effectively. Nevertheless this system allows for the possibility of some protection for the non-adjusting creditors, and there are other mechanisms available to protect these creditors.

As regards the involuntary creditors, compulsory insurance schemes cover the majority of tort claims against companies, namely those arising from accidents at work and road traffic accidents.[54] Employees are covered by a range of employment legislation to protect them, and are placed in the category of preferred creditors on a winding up as regards the payment of at least some of the money owed to them. This raises an important issue. Creditors are principally in need of protection from shareholders when the company is insolvent and the protections which adjusting creditors can bargain for themselves are of primary benefit in the event of insolvency. By the same token, non-adjusting creditors are most in need of protection when the

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[50] Although see in this regard eg C Leuz et al, "An International Comparison of Accounting –Based Payout restrictions in the United States, United Kingdom and Germany" (1998) 28 Accounting & Business Research 111, and, more recently, M Bradley and M R Roberts, "Are Bond Covenants Priced?" http://repec.org/esNASM04/up.21166.1069857472.pdf where the authors argue that dividend restrictions in state corporate law codes in the US are associated with better credit ratings for bonds issued by firms incorporated in those jurisdictions. However, these findings should be treated with care, not only because the results themselves may be questioned (in the Bradley and Roberts study many codes restricted dividends but not other forms of return of capital and so it is difficult to see how they could have any real effect) but also because even if there are some potential costs savings via this form of collective bargaining it is not clear whether these are captured by the capital maintenance doctrine and indeed the doctrine itself has a significant cost element (see nn 41-44 and associated text) (for discussion see J Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' (2000) 63 MLR 355, 374).

[51] E Ferran, 'The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union' (2006) 3 European Company and Financial Law Review 178.

[52] *Ibid.*, 189.

[53] Eg Enriques and Macey, (suprs n 11) 1172. In the UK it is sometimes suggested that secured creditors are often vastly over-secured (see eg R J Mokal, *Corporate Insolvency Law: Theory and Application* (OUP, 2005) 210-212 cf S Davydenko and J Franks, "Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK (2008) Journal of Finance, forthcoming). If correct, this would reduce the strength of the free-riding argument to some extent, but would not destroy the argument entirely.

[54] Employers' Liability (Compulsory Insurance) Act 1969; Road Traffic Act 1988; Third Parties (Rights Against Insurers) Act 1930.

company is insolvent. The availability of creditor protection once the company is insolvent is dealt with in the next section.

(iii) Creditor protection on insolvency

Creditor protection from the shareholders is of principal importance when the company is insolvent. At that point there will generally be insufficient money to satisfy all the claims against the company and the conflict between the shareholders and the creditors will be clear. However, on insolvency the creditors are put in the driving seat and insolvency law protects the creditors from the shareholders' claims.

Statutory provisions are in place to ensure that the shareholders don't undermine the principle that creditors rank ahead of the shareholders at this point in time.[55] The courts are also keen to ensure that the statutory order of payment out on a winding up is not undermined. There are numerous examples of this in insolvency cases. An interesting example of this principle at work in a company law case is the House of Lords' decision in *Johnson v Gore Wood & Co*.[56] In this case their Lordships considered whether a shareholder should be able to recover for reflective loss ie loss which is merely a reflection of the loss suffered by the company and which will be fully compensated if the company sues successfully to recover that loss. If the shareholder is allowed to recover then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company. The problem can be solved either by disallowing the corporate claim and allowing the shareholders to sue individually or by disallowing the individual claims. The House of Lords preferred the latter approach. As Lord Millett explained, disallowing the corporate claim would prejudice the company's creditors if the company becomes insolvent as a result of the wrongdoing since on insolvency it is the creditors and not the shareholders who primarily benefit from the corporate action. To allow a corporate asset - the right to sue the wrongdoers - to be given to the shareholders individually at this point would subvert the normal positions of creditors and shareholders on insolvency.

On insolvency, then, the rules regulating the order of payment out on a winding up are effective at protecting creditors from the claims of shareholders, which is the principal concern of the legal capital rules. The priority rules are less effective at protecting the unsecured creditors from the claims of the secured creditors on insolvency, but this is a different issue and something which the legal capital rules do not purport to address.

Following the Enterprise Act 2002 this issue is tackled to some extent by the ringfenced fund which redistributes some funds from the floating charge holder to the unsecured creditors.[57] Other redistribution also occurs, for example assets subject to the floating charge can be used by administrators to keep the company running for the potential benefit of all creditors.[58] A strong argument has been put forward against any form of redistribution from secured to unsecured creditors on the basis that the justifications for such redistribution are not made out and redistribution simply distorts patterns of borrowing.[59] However this issue is beyond the scope of this paper, being outside the remit of the legal capital rules.

The suggestion is, therefore, that while the company remains solvent creditors are in need of no special protection from the law. It is notable that at this point the law does not separate creditors' interests from those of the shareholders in determining the scope of directors' duties. Section 172 of the Companies Act 2006 does separate a number of other stakeholder groups which require consideration by directors when determining what is "most likely to promote the

[55] Insolvency Act 1986, s 74(2)(f).
[56] [2001] 1 All ER 481.
[57] Enterprise Act 2002, s 252 inserted as Insolvency Act 1986, s 176A.
[58] Insolvency Act 1986, Sch B1, para 70. See also liquidation expenses as from 6 April 2008: Companies Act 2006, s 1282, reversing *Buchler v Talbot* [2004] UKHL 9.
[59] J Armour, "Should we redistribute in insolvency?" in *Company Charges: Spectrum and Beyond*, eds J Getzler and J Payne (OUP, 2006).

success of the company for the benefit of its members as a whole".[60] However, creditors are absent from this list, and rightly so. The creditors' primary interest in the company is the return of their investment and while there is adequate money to pay them they have no need of additional protection from the law.[61] This changes only where the company is insolvent or on the threshold of insolvency. Where the company is insolvent, although the creditors do need protection from the shareholders, this protection is provided to some extent by contract, which allows some of the creditors to protect themselves, for example by taking a fixed charge and therefore having a proprietary claim against the company on insolvency, and that, to the extent that any additional protection is needed (in particular for the non-adjusting creditors), this is provided by insolvency law.

One argument that could be raised against this approach is that the definition of insolvency is notoriously difficult and therefore it should not be used as a hard boundary between creditor protection (in addition to contractual protection) and no creditor protection. There is obviously a period just prior to insolvency when the creditors do become in need of protection although formal insolvency procedures have not begun. The law recognises this grey area already. The directors' duty to have regard to the creditors' interests operates when the company is *nearing* insolvency[62] and many of the provisions in the Insolvency Act 1986 take account of behaviour in the period before insolvency.[63] If there is a concern that the boundary between solvency and insolvency means that creditors are potentially left unprotected in this twilight zone then it would be better to focus on providing more protection for creditors at this time, or clarifying the definition of insolvency, rather than legislating for the entire period when the company is solvent. However, there is a danger of over-regulation of this area.[64] The Company Law Review did consider increasing directors' obligations to creditors. One early suggestion was that the common law duty on directors to consider creditors' interest at or near insolvency should be moved further back into the solvent life of the company so that this obligation should kick in when insolvency was merely in prospect. This was dropped due to fears that it would have a "chilling effect" ie it would encourage directors to move too precipitously to put companies into liquidation, and not to risk trying to trade out of their difficulties with the attendant risk of being sued by the liquidator on the creditors' behalf if they failed and worsened the creditors' position in the meantime.[65] The Companies Act 2006 maintains the previous position regarding directors' duties to creditors.[66]

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[60] Companies Act 2006, s 172(1).

[61] One gloss could be added to this: if the riskiness of the company's business increases dramatically this will increase the probability of default and may reduce the market value of debt claims, even if the company never in fact does default. However, if the company remains solvent this does not impact on the creditors' likelihood to be repaid and so this does not seem to be an area in which the law needs to intervene.

[62] *West Mercia Safetywear Ltd v Dodd* [1998] BCLC 250.

[63] Eg Insolvency Act 1986, s 214, although s 214 can operate at a very late stage indeed. It may will be possible to continue to trade long after balance sheet insolvency as long as the principal creditors continue to support the company. See eg P Davies, "Directors' Creditor-Regarding duties in respect of trading decisions taken in the vicinity of insolvency" (2006) European Business Organization Law Review 301.

[64] See eg B Cheffins, *Company Law: Theory Structure and Operation* (OUP,1997) p 540 et seq.

[65] White Paper, *Modernising Company Law* (Cm 5553-I, July 2002) para.s 3.8-3.14.

[66] Prior to the Companies Act 2006, directors' duties to creditors comprised a common law obligation to have regard to the creditors' interests when the company is insolvent or borderline insolvent (*West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250) and a number of statutory enactments, principally the wrongful trading provisions in s 214 of the Insolvency Act 1986. Section 172(3) of the Companies Act 2006 embeds these obligations within the new legislation. Section 172(3) states that the duty imposed on directors by s 172 to promote the success of the company is subject to any enactment (eg s 214) or rule of law (the common law duty to creditors). In addition, the CLR considered whether the duty of directors to act in the interests of the company "should be interpreted as meaning simply that they should act in the interests of the shareholders, or whether they should also take account of other interests, such as those of employees, creditors, customers, the environment, and the wider community". The CLR did not recommend this pluralist approach, but instead suggested an "enlightened shareholder value" approach whereby directors in a solvent company would exercise their powers for the "success of the company for the benefit

Another counter-argument is that even if the company does not become insolvent as a result of the distributions to shareholders, the creditors' interests can nevertheless be harmed because the distributions do reduce the company's net assets and therefore make it more exposed to the risk of default.[67] Creditors, it is argued, are still prejudiced if the risk of default increases above that at which they priced it and if the value of their debt claim matters to them as an asset.[68] However, a restriction on the return of capital to shareholders per se is of little assistance to non-adjusting creditors.[69] Although some benefits may accrue to the adjusting creditors, because such restrictions may deter ex post actions by the shareholders[70] this is a group which is in a position to protect itself by contract. It is accepted that this protection has its limits[71] and there may be some inefficiencies, in the sense of failing to maximise the expected value of corporate assets, if such distributions are allowed. However, it may be questioned whether this justifies the imposition of the legal capital rules in a solvent situation when these inefficiencies are weighed against the costs of the legal capital rules themselves. The suggestion therefore is that creditors are able to protect themselves by contract, and that creditors only need additional protection on insolvency, at which point the insolvency rules are adequate to provide that protection.

(iv) Summary

Strong arguments can be made against the legal capital rules in place prior to the implementation of the Companies Act 2006. It is difficult to justify the imposition of costly and burdensome legal capital rules constraining a company's actions while solvent, when the need for creditor protection arises predominantly on insolvency; these costly rules are also difficult to justify when many creditors are in a position to protect themselves by contract and even those that aren't are able to free ride to some extent. Even if the needs of non-adjusting creditors aren't met via free riding, the legal capital rules do not provide them with any meaningful protection. In short, the legal capital rules in place under the Second Directive, and to date implemented into UK law by the Companies Act 1985, are expensive and largely ineffective as creditor protection devices. Even if small benefits are obtained, any benefit gained is outweighed by the costs of the system.

As a result it might have been hoped that legislators would take the opportunity presented by the company law reform process which culminated in the Companies Act 2006 to dismantle the legal capital regime as far as feasibly possible in order to leave creditor protection to be supplied by the twin mechanisms of contract and insolvency law. The next section will assess the reforms introduced by the Companies Act 2006.

4. Legal capital rules in the Companies Act 2006

The Companies Act 2006 was preceded by a substantial review of UK company law. The legal capital rules in place in the Companies Act 1985 and in the common law were carefully scrutinised by an independent Steering Group, the Company Law Review Steering Group, as part of this process. When this Company Law Review (CLR) was established, it had been nearly 40 years since the last broad review of company law had been carried out, by the Jenkins

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of its members" but that due recognition should be given to the interests of other matters, listed in s 172(1)(a)-(f). The company's creditors were not included in this list however. To do so would have meant a significant shift in the law, and would have required the directors to have regard to the creditors' position when making decisions even when the company is clearly solvent.

[67] See J Armour, "Legal Capital: An Outdated Concept?" (2006) EBOR 5, 11-15.

[68] Eg where the creditor wishes to realise the value of the loan before maturity, as with bonds, factoring of book debts etc.

[69] This is because if creditors do not adjust, the optimal level of capitalisation by shareholders is zero: J Armour, "Legal Capital: An Outdated Concept?" (2006) EBOR 5, 12.

[70] Ibid, p12-13.

[71] Eg there are limits to the interest rates which it is feasible to charge.

Committee in 1962.[72] The Steering Group produced a large number of papers which considered the issue of legal capital, either specifically, or as part of the overall package of possible reforms[73] which were then considered and further amended by the Government in its response to these proposals.[74] Many of the objections to the legal capital regime set out above were taken on board by the CLR. As a result, the starting point of the CLR was that "creditors and potential creditors do not any longer regard the amount of a company's issued share capital as a significant matter when deciding whether or not to extend credit to it"[75] and that the scheme of capital maintenance measures in place at that time should be relaxed. Unfortunately, at the time of the CLR, no review of the Second Directive was in prospect. As a result, the CLR was constrained as to the legal capital reforms it could recommend. In short, while the CLR could make significant recommendations for reform in relation to private companies, they were faced with the political impossibility of altering the public company provisions which implemented the Second Directive. Faced with this dilemma, in some instances the CLR recommended different regimes for public and private companies. In relation to financial assistance therefore the CLR recommended the end of this regime for private companies, while leaving it in place, and substantially unchanged, for public companies.[76] Unfortunately, in other areas, the constraint on reform for public companies also led to a constraint for private companies. The most obvious example of this is in relation to par value shares. The CLR initially stated that "the requirement that shares should have a nominal value has become an anachronism"[77] and suggested that no par value shares be introduced, arguing that there is no reason to impose any particular limit below which the issue price cannot fall as long as all of the proceeds of the issue are retained in an undistributable capital account. However, the Second Directive prevents these reforms being introduced for public companies.[78] As a result, these proposals were dropped altogether for both public and private companies. The Companies Act 2006 does not contain a radical reformulation of the rules regarding a company's legal capital, although there is some significant de-regulation for private companies. The rules can still be divided into those provisions that are intended to ensure that a certain guaranteed cushion is created for creditors by ensuring that shareholders pay a certain amount into a company (the minimum capital rules) and those which attempt to ensure that this cushion isn't returned to the shareholders in certain circumstances (maintenance of capital).[79]

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[72] *Report of the Company Law Committee*, Cmnd 1749 (1962).

[73] *The Strategic Framework*, February 1999 (URN 99/654); *Company Formation and Capital Maintenance* (URN 99/1145); *Developing the Framework* (URN 00/656); *Completing the Structure* (URN 00/1335); *Final Report* (URN 01/942 and URN 01/943).

[74] White Paper, *Modernising Company Law* (Cm 5553-I and 5553-II), July 2002, and White Paper, March 2005 and further draft clauses and explanatory material, Sept and Oct 2005.

[75] *The Strategic Framework*, February 1999 (URN 99/654), 82.

[76] Financial assistance provisions were not regarded as "strictly necessary for the maintenance of capital" (*The Strategic Framework*, February 1999 (URN 99/654), 87) although it was initially only recommended that companies should be permitted to give all kinds of financial assistance if approved in general meeting by disinterested members and preceded by a declaration of solvency. By the *Final Report* this was replaced by the more radical suggestion that the prohibition on giving financial assistance for the purchase of own shares should be abolished altogether, although only for private companies (*Final Report*, (URN 01/942), para 10.6).

[77] *The Strategic Framework*, February 1999 (URN 99/654), 88.

[78] Art 32 of the Second Directive sets out safeguards for creditors on a capital reduction, including the right to apply to court, something which "puts unjustifiable power in the hands of creditors" according to the CLR (*The Strategic Framework*, February 1999 (URN 99/654), 84). Articles 19 and 22 of the Second Directive constrain the ability of public companies to purchase their own shares and Article 23 prevents the implementation oft the CLRSG's proposals in the Strategic framework. Although there is no formal requirement in the EU Company law directives for shares to have a nominal value, both the Second and Fourth directives require that shares have assigned to them, if not a nominal value then at least an "accounting par" or "accounting par value". Article 8 of the Second Directive requires that no par value shares of public companies should not be issued below their "accountable par". The Second Directive therefore prevents a true no par value scheme being put in place.

[79] The deadline for the full implementation of the Companies Act 2006 has been extended to 1 October 2009. Many of the legal capital measures are only due to be implemented on that long stop date, although some (eg the

(i) Minimum capital rules

These rules come in two parts: requirements as to amount which must be invested by shareholders before business can be commenced, "the entry price for limited liability",[80] and rules governing the measurement of the consideration provided by the shareholders for those shares, to ensure that the proper value is received.

Following the implementation of the Companies Act 2006, companies will not have to have an authorised share capital.[81] However, the Second Directive[82] requires that the initial documentation provided by public companies without authorised share capital must state the amount of the subscribed capital. The 2006 Act stipulates those occasions on which all companies with a share capital, whether public or private, must provide the registrar with a statement of capital, and this includes on an application to register companies (both public and private) having a share capital.[83]

The Companies Act 2006 continues to impose an obligation for public companies to have a minimum share capital of £50,000,[84] of which a quarter needs to be paid up.[85] This is a repetition of the equivalent provision in the Companies Act 1985.[86] The Companies Act 2006 introduces no changes for private companies: no minimum share capital is required for them. As for ensuring that appropriate consideration is received in return for shares issued to shareholders, the Companies Act 2006 continues to require that all shares have a fixed nominal value[87] and that companies may not issue shares at a discount to their par value.[88] Companies with share capital can have those shares denominated in any currency or in several currencies, although to obtain a trading certificate as a public company or to re-register as a public company, a company must have the authorised minimum capital denominated either in sterling or in euros (but not in a mixture of the two).[89] One innovation in the 2006 Act is a new statutory procedure for all companies to redenominate the currency of share capital without an application to the court.[90] It is unfortunate that the anachronistic concept of par value is retained by the Companies Act. Par value is a meaningless and valueless concept whose continued existence is difficult to justify, except insofar as the Second Directive continues to require it for public companies.

In regard to shares issued for non-cash consideration, in private companies this continues to be a matter for the directors' business judgement,[91] but in public companies the Second Directive requires a stricter rule.[92]As a result the Companies Act 1985, and now the Companies Act 2006, requires a mandatory valuation of noncash consideration received by public

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provisions relation to distributions and minimum capital requirements) will be implemented on 6 April 2008. For the full implantation schedule see www.berr.gov.uk/files/file42847.doc.

[80] D D Prentice, "Corporate Personality, Limited Liability and the Protection of Creditors" in R Grantham and C Ricketts, eds, *Corporate Personality in the Twentieth Century* (Oxford, Hart Publishing, 1998) 99.

[81] Companies Act 2006, s 10.

[82] Second Directive, art 2.

[83] Companies Cat 2006, s 10.

[84] Companies Act 2006, s 763, as required by Art 6 of the Second Company Law Directive (77/91/EEC).

[85] Companies Act 2006, s 586 (formerly Companies Act 1985, s 101) and see Second Directive, Art 9(1).

[86] Companies Act 1985, ss 117-118.

[87] Companies Act 2006, s 542 (Companies Act 1985, s 2(5)(a)). Shares can be denominated in any currency (s 542(3) although for a public company the amount needed for the authorised minimum capital must be in sterling or euros (see *Re Scandinavian Bank Group plc* [1988] Ch 87).

[88] Companies Act 2006, s 580 (Companies Act 1985, s 100); *Ooregum Gold Mining Co v Roper* [1892] AC 125. This is a requirement of the Second Directive, art 8(1).

[89] Companies Act 2006, s 765(1).

[90] Ibid., s 622-628.

[91] *Re Wragg* [1897] 1 Ch 796.

[92] The Second directive was amended in 2006 in relation to the rules regarding the assessment of noncashconsideration received in consideration for the issue of shares in public companies: Adoption of the amendment of the second company law directive (July 2006) available at http://ec.europa.eu/internal_market/company/capital/index_en.htm. DBERR (formerly the DTI) has no plans to implement these changes into UK legislation at the present time.

companies.[93] In addition some forms of non-cash consideration, most notably an undertaking to do work or to perform services,[94] are prohibited altogether. A detailed report[95] is required by an independent valuer during the six months preceding the allotment. The report must support the conclusion that the consideration received by the company is not less than the nominal value of the shares plus any premium.[96] The requirement for this report, and the detailed requirements attached to it in the Companies Act 2006 are a repetition of the requirements of the Companies Act 1985 without any substantive changes.

(ii) Maintenance of capital

In contrast to the rules regarding minimum capital, which draw a sharp distinction between the rules for public and private companies, in general the Companies Act 1985 imposed the capital maintenance rules set out in the Second Directive on all companies, not just public companies. Although some concessions were made for private companies[97] the restrictions placed on private companies regarding the management of their legal capital under this regime remained substantial. Changes introduced by the Companies Act 2006 have relaxed the restrictions placed on private companies very considerably. The most obvious example of this is the changes to the rules regarding financial assistance. Under the Companies Act 2006, public companies continue to be faced with a prohibition on the giving of financial assistance for the purchase of their own shares in almost identical terms to that under the Companies Act 1985,[98] despite some substantial problems with the sections as drafted,[99] and some significant recommended reforms.[100] The 2006 Act continues to be wider in scope in this respect than the Second Directive requires.[101] However, the ban on the giving of financial assistance no longer applies to private companies.[102]

As regards reductions of capital, the Companies Act 2006 retains the court-approved reductions of capital for both public and private companies, which were found in the Companies Act 1985, and which the CLR felt put "unjustifiable power in the hands of creditors"[103]. Section 641 of the Companies Act 2006 allows for both public and private companies to reduce their

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[93] Companies Act 2006, s 593 (Companies Act 1985, s. 103). There are exceptions eg for bonus issues and most types of takeovers and mergers (Companies Act 2006, ss 593-595, formerly Companies Act 1985, s 103). For the procedure, see Companies Act 2006, ss 596-597 (Companies Act 1985, ss 108- 109).

[94] Companies Act 2006, s 585 (Companies Act 1985, s 99(2)), as required by Art 7 of the Second Directive.

[95] Companies Act 2006, s596 (Companies Act 1985, s 108).

[96] Companies Act 2006, s 108(3)(d) (Companies Act 1985, s 108(6)(d)).

[97] Eg, in relation to financial assistance, a whitewash procedure (Companies Act 1985, ss 155-158) allowed private companies to bypass the general prohibition on the giving of financial assistance (Companies Act 1985, ss 151-153) in some circumstances.

[98] Companies Act 2006, ss 677-680 (Companies Act 1985, ss 151-153).

[99] For example, there has been no attempt to either clarify or replace the "principal purpose" exemption stated in s 679(2) (see *Brady v Brady* [1989] AC 755).

[100] In 1996 and 1997 the DTI made proposals to improve the drafting of the sections on financial assistance, proposals which were supported by the CLR (see *Company Formation and Capital Maintenance* (URN 99/1145) paras 3.42-3.42 where the proposed changes are summarised).

[101] Eg the Second Directive does not expressly require the prohibition of assistance given after the acquisition. The 2006 Act does not confine the prohibition on financial assistance to post-transaction financial assistance given pursuant to pre-acquisition understandings or arrangements to give posttransaction financial assistance and instead retains a prohibition on financial assistance given for the purpose of reducing or discharging a liability incurred for the purpose of an acquisition of shares, whether or not it is given pursuant to a pre-acquisition understanding or arrangement (s 679(3)).

[102] Since the rules on maintenance of capital continue to apply to private companies there is a danger that some corporate actions that would have infringed the ban on financial assistance will remain unlawful notwithstanding this repeal because they are contrary to the maintenance of capital regime. The Government has agreed to make it clear in a saving provision under s 1296 Companies Act 2006 that the removal of the prohibition on private companies giving financial assistance for the purchase of own shares will not prevent private companies entering into transactions which they could lawfully have entered into under the whitewash procedure (Lord Sainsbury, Hansard, HL Vol 686, cols 443-444 November 2, 2006).

[103] *The Strategic Framework*, February 1999 (URN 99/654), 84.

capital by way of a special resolution which is subsequently confirmed by the court.[104] Creditors are entitled to object to the reduction where their interests may be adversely affected, such as where the reduction involves a repayment to shareholders[105] rather than merely cancelling share capital which is unrepresented by a company's available assets.[106] If creditors interests are not properly dealt with in a reduction the court has a discretion whether to confirm a reduction of capital or not.[107] These provisions mirror those contained in the Companies Act 1985. The Companies Act 2006 does introduce a new method of reducing capital for private companies, by way of a special resolution coupled with a solvency statement from the directors. The CLR initially recommended that this method should replace the court approval method for private companies, although this recommendation was later dropped.[108] The CLR also recommended that public companies be allowed to reduce their capital on this basis, without having to seek court approval.[109]

Compliance with the Second Directive requirement that creditors whose claims antedate the publication of the decision to reduce capital should be entitled to have a right to obtain security for their claims[110] would have been achieved by providing creditors with the opportunity, at their initiative, to challenge a reduction in court. However, the government decided against introducing this change for public companies.[111]The contents of the solvency statement required for a reduction of capital are almost identical to those of the statutory declaration or statement that used to be required of directors under the now repealed private company financial assistance "whitewash" procedure,[112] although the statutory statement for a reduction of capital does not need to be accompanied by an auditors' report.[113] There are also close similarities between this statement and that required of directors in the procedure whereby private companies can repurchase their shares from capital.[114]The statement must be made by all directors and the directors must take account of prospective and contingent liabilities of the company.[115] Making a statutory statement without having reasonable grounds for the opinions expressed in it is a criminal offence for which the maximum penalty is imprisonment for up to two years.[116] Although this procedure offers a measure of deregulation for private companies, there are many reasons, both presentational and practical, why private companies will still follow the more cumbersome and expensive court approval route. These include the desire to draw as complete a line as possible under a particular change of share capital, the desire to obtain the court's approval for an unusual reduction,[117] in circumstances where the directors are faced with a difficulty in forming the opinion required for the solvency statement, or to access the more generous provisions regarding subsequent distributions of the reserve which attach to reserves arising from a court approved reduction of capital.[118] There has been some general de-regulation

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[104] See Companies Act 1985, s 135 for the equivalent provision in that legislation.
[105] Companies Act 2006, ss 645(2) and (4), 646 (Companies Act 1985, s 136).
[106] Ibid, s 645(3).
[107] Ibid, s 648 (Companies Act 1985, s 137); *Prudential Assurance Co Ltd v Chatterley-Whitfield Collieries Co Ltd* [1949] AC 512.
[108] *Company Formation and Capital Maintenance* (URN 99/1145) para 3.27; *Completing the Structure* (URN 00/1335) para 7.9.
[109] *Company Formation and Capital Maintenance* (URN 99/1145) para 3.27-3.35.
[110] Second Directive, art 32.
[111] White Paper, March 2005 (Cmnd 6456).
[112] Companies Act 1985, s 155.
[113] Ibid, s 643.
[114] Companies Act 1985, ss 171-177, now recast in ss 709-723 Companies Act 12006, although the buy-back procedure has been revised to require the directors to make statutory statements of solvency rather than statutory declarations (s 714).
[115] Ibid, s 643(1) and (2).
[116] Ibid, s 643(4) and (5).
[117] A company proposing to reduce its share capital to zero must ask the court to confirm the reduction: s 641(2)
[118] Where the reduction is confirmed by court, reg 9 of the draft Companies (Shares, Share Capital and Authorised Minimum) Regulations 2007 makes the reserve distributable and also makes the reserve a realised profit except to

of the ability of directors of companies to manipulate the share capital of the company. These are generally creditor-neutral.

Under Companies Act 2006 directors of private companies with a single class of shares will have authority to allot shares of that class unless the articles prohibit them from doing so,[119] whereas the directors of public companies, and private companies with more than one class of shares can only allot shares if they are authorised to do so by the articles or a resolution of the company.[120] Furthermore directors of a private company with only one class of shares can now be given power by the articles or by a special resolution to allot shares without complying with the statutory pre-emption provisions.[121] Pre-emption offers can now be communicated to shareholders electronically.[122] For convenience, Companies Act 2006 clarifies that the powers to alter capital, whether by increasing capital through the allotment of new shares, reducing share capital in accordance with Chapter 10 of the 2006 Act, or subdividing and consolidating share capital,[123] do not now have to be exercised by the company in general meeting, although their exercise must be authorised by a resolution by the members. In practice this means that private companies can make use of the statutory written resolution procedure[124] and public companies can make decisions by the *Duomatic* principle,[125] although given that this principle demands unanimity it is of use only in very small companies and therefore is unlikely to be of much assistance for most public companies. In the Companies Act 2006, the starting point for maintenance of capital issues continues to be that any form of distribution of corporate assets to shareholders is prohibited except where the value of the distribution is less than that of the assets available for distribution. Distributable profits continue to be the company's "accumulated realised profits…less its accumulated realised losses"[126]. The definition of "distribution" continues to be broad, including not only dividend payments but also the redemption or repurchase of shares. The central idea is that capital must not be returned to the shareholders. As discussed above, the UK's interpretation of capital under the Companies Act 1985 was wider than strictly required by the Second Company Law directive and included any share premium and capital redemption reserve.[127] The Companies Act 2006 makes no change to the rules regarding the treatment of the share premium account in this regard.[128] Although the position regarding capital redemption reserves is the same, namely that such reserves are not distributable, the Companies Act 2006 makes provision for this position to be reviewed by the Secretary of State in the future.[129] As regards dividend payments, the provisions in Part 23 of the Companies Act 2006 broadly restates the substance of Part VIII of the 1985 Act, although the opportunity was taken to reorganise and reword some of the sections. One innovation is the treatment of distributions in kind. Section 845 of the Companies Act 2006 is intended to remove

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the extent that the court provides otherwise. Where the reduction follows a solvency statement reg 9 makes the reserve distributable only to the extent that it is treated as a realized profit.

[119] Companies Act 2006, s 550

[120] Ibid, s 551.

[121] Ibid, s 569. Directors of public companies and private companies with more than one class of shares can be given power by the articles or by a special resolution to allot shares pursuant to their general authorisation under s 551 without complying with the statutory pre-emption provisions (s 570 and see also s 571).

[122] Ibid, s 562(2). Whatever form of communication is used, companies will have to communicate offers to all shareholders with a registered address in an EEA state, not merely those with a registered address in the UK (s 562(3)).

[123] Ibid, s 618.

[124] Ibid, ss 288-300.

[125] It was doubtful whether the *Duomatic* principle applied to eg s 121 Companies Act 1985 because that section specifically referred to the powers conferred by that section being exercised by the company in general meeting. This wording is removed in the Companies Act 2006 see eg s 618(3).

[126] Companies Act 2006, s 830 (Companies Act 1985, s 263(3)).

[127] Companies Act 1985, ss 130(3), 170(4).

[128] The Companies Act 2006 does make some changes to the way in which companies can deal with share premiums, but these amount to a restriction of companies' flexibility: s 610.

[129] Companies Act 2006, s 654.

doubts raised by the decision in *Aveling Barford Ltd v Perion Ltd*[130] regarding when a transfer of an asset to a member amounts to a distribution. This is a useful provision but hardly amounts to a substantive change of the provisions regarding dividends.

Redemptions and repurchases of shares continue to be permitted.[131] The Companies Act 2006 introduces some relaxation regarding the terms and manner of redemption, as recommended by the CLR.[132] As a result Companies Act 2006 allows the directors of both public and private companies to determine the terms and manner of the redemption if they are authorised to do so under the articles or by an ordinary resolution.[133] The issue of redeemable shares by private companies no longer requires the prior authorisation in the articles[134] although this requirement remains in place for public companies.[135] The terms of redemption no longer have to provide for payment on redemption.[136]Likewise, the Companies Act 2006 does not require a company proposing to purchase its own shares to have the authority to do so in its articles.[137]

Otherwise, the procedure for redemptions and repurchases under the Companies Act 2006 follows broadly the same form as existed under the Companies Act 1985. Redemptions and repurchases must still be funded out of distributable profits or a fresh issue of shares in order not to reduce share capital[138] although private companies continue to be allowed to repurchase shares out of capital in some circumstances.[139]

Initially the CLR recommended the repeal of these latter sections on the basis that the simplified reduction of capital procedure introduced for private companies would make them unnecessary. In practice the sections in the 1985 Act had been used by private companies as a simplified reduction procedure. However, these provisions were later reprieved on the basis that there would still be occasions when these sections would be useful to private companies, where the reduction procedure may not be available.[140]

(iii) Summary

The Companies Act 2006 substantially de-regulates the legal capital rules for private companies. As discussed, the ban on providing financial assistance has been removed for these companies, private companies can now reduce their capital by way of a solvency statement and a special resolution, and the rules governing redemptions and repurchases of a company's own shares have been relaxed. In addition the rules governing the ability of directors to manipulate the share capital of a company, eg by increasing capital though an allotment of new shares, or

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[130] [1989] BCLC 626.

[131] Companies Act 2006, ss 684-689 (Companies Act 1985, ss 159-160) as regards redemptions of shares and Companies Act 2006, ss 690-708 (Companies Act 162-169A) as regards purchases of own shares.

[132] Eg The CLR recommended that there be a relaxation of s 160(3) Companies Act 1985 which required the terms and manner of redemption to be fixed by the articles (*Final Report*, (URN 01/942) para 4.5).

[133] Companies Act 2006, s 685.

[134] It will still be possible to use the articles to exclude or restrict the use of redeemable shares: s 684(2).

[135] Companies Act 2006, s 684(3).

[136] Ibid, s 686. This allows for payment at a later date (s 686(2) and for payment on more than one date (cf *BDG Roof-Bond Ltd v Douglas* [2000] 1 BCLC 401). Somewhat strangely it is not open to a company to make payments on more than one date on a purchase of its own shares (s 691).

[137] However, the articles may restrict or prohibit the company's purchase of its own shares (s 690(1)).

[138] Companies Act 2006, s 687 (Companies Act 1985, s 160(1) and (2)).

[139] Companies Act 2006, ss 709-723 (Companies Act 1985, ss 171-177). There have been some small changes to the process eg the directors' statement need not be a statutory declaration, and there have been changes to the description of the contingent and prospective liabilities that must be taken into account when the directors form their opinion (s 713).

[140] An example was given in the course of the parliamentary debate. This was where a company has no share premium or other capital reserves but wishes to purchase its shares at above the nominal value. The reduction procedure would not allow that, due to insufficient capital, but these sections might since they, unlike the reduction procedure, treat any revaluation reserves (unrealised profits) as being capital. This would allow companies to continue to distribute surplus cash in circumstances where they have no distributable profits (see Hansard, HL GC Day 10, cols 32-33).

subdividing capital, have been simplified and issues such as redenomination of share capital have been made easier. However, the legal capital regime has not been entirely dismantled. Shares must still have a par value and cash consideration received for shares must still be pegged against that artificial concept. The distribution rules are left unchanged so that the balance sheet test will continue to regulate distributions to shareholders.

However, the ability of directors of private companies to avoid the dividend rules by returning capital to shareholders by means of a share repurchase means that this constraint may have relatively little impact in practice.

It is interesting to note that even before the changes introduced by the Companies Act 2006 UK private companies were viewed as an attractive option for European entrepreneurs. A result of the *Centros* decision[141] and of the cases that have followed it, has led to substantial numbers of entrepreneurs living and trading on the continent establishing private companies in the UK in order to take advantage of the comparatively more relaxed capital regime for private companies in the UK.[142] The further deregulation of the capital regime for private companies in the UK is likely to exacerbate this effect.

By contrast, the Companies Act 2006 has not made significant changes to the capital regime in place for public companies. As discussed in Part 3, there has been some simplification and de-regulation at the margins, eg regarding the redenomination of share capital, but for all intents and purposes the legal capital regime in place for public companies before the Companies Act 2006 will still be in place once this Act is fully implemented. There are strong arguments for dismantling the legal capital regime and leaving creditor protection to be dealt with via a mixture of contract and insolvency rules. Perhaps the strongest arguments for the retention of any of these rules relate to the pre-emption rules, which act as shareholder rather than creditor protection devices. These can be justified, in a public company context, by reason of their corporate governance role.[143] However, this is an issue in which institutional investors have a strong interest[144] and there is good reason to believe that if the statutory regulation of pre-emption rights was removed, that institutional investors would impose their own equivalent rights and that commercial pressures would mean that companies would comply with them in the ordinary course of events.

Ultimately the primary justification for leaving the legal capital rules for public companies as they are is the need to comply with the Second Directive. Until the Second Directive is substantially reformed[145] or removed, the UK's legal capital rules for public companies will not change substantively. However, there are signs of a shift in attitude within Europe regarding the need to impose stringent legal capital rules in order to provide creditor protection.

5. The future

In Europe, there has recently been a shift away from the view that creditors need statutory protection during the solvent life of the company and that detailed legal capital rules are the way to provide that protection. There has been strong academic support for a relaxation of the legal capital rules for some time, within the UK and beyond.[146] This support has now spread beyond

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[141] *Centros Ltd v Erhvervs-og Selskabsstyrelsen* Case C-212/97.

[142] M Becht, C Mayer, H Wagner, Corporate Mobility Comes to Europe: The Evidence, Working Paper, Universite Libre de Bruxells/Said Business School, Oxford University (October 2005).

[143] Pre-Emption Rights: Final Report, A report by Paul Myners into the impact of shareholders' preemption rights on a public company's ability to raise new capital, February 2005 (URN 05/679); J Franks and C Mayer "Governance as a Source of Managerial Discipline" available at http://www.dti.gov.uk/cld/franksreport.pdf.

[144] See eg Pre-Emption Guidelines available at www.ivis.co.uk/pages/framegu.html.

[145] Minor amendments were made to the Second Directive in July 2006: Adoption of the amendment of the second company law directive (July 2006) available at http://ec.europa.eu/internal_market/company/capital/index_en.htm. DBERR (formerly the DTI) has no plans to implement these changes into UK legislation at the present time.

[146] Eg J Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law' (2000) 63 MLR 355, E Ferran, 'The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the

the academic community. There have been a number of strands to this development. First, the European Commission's Action Plan for Company Law marked a shift away from the role of company law at the European level being the protection of those who deal with companies in favour of an approach based on business efficiency and competitiveness.[147] Within this new approach creditor-protection devices can still be retained if they are necessary on the grounds of efficiency and competitiveness, but as we have seen, the current legal capital regime is hard to justify on this basis, and indeed can on one level be said to be hampering European competitiveness when compared to other jurisdictions, notably the US.[148] Second, the ECJ in *Centros*[149] were clear that there was no unique value in the legal capital rules as a creditor protection device. As discussed, the *Centros* decision has led to a substantial numbers of entrepreneurs living and trading on the continent establishing private companies in the UK in order to take advantage of the comparatively more relaxed capital regime for private companies in the UK. In turn this has led to a process of negative harmonisation and a relaxation of capital maintenance regimes in Europe.[150]

In the UK the Government has unequivocally stated its support for more flexibility than is permitted by the Second Directive[151] and there has been a re-examination of the function and role of the Second Directive at European level.[152] At the heart of the recommendations for change put to the Commission was that the payment of dividends and other distributions would be based on a solvency test, possibly combined with something akin to section 214 of the Insolvency Act 1986 on a European wide basis. A solvency test has some significant attractions when compared to the present legal capital system, and would bring the EU in line with the trend in other industrialised economies.[153] However, the proposals put forward by the Commission for the amendment of the Second Directive[154] were more limited in scope that these suggested reforms. The resulting amendments[155] do allow a relaxation of the rules governing the need for an expert valuation when non-cash consideration is received by public companies in exchange for its shares,[156] a relaxation of the rules governing financial assistance,[157] and a relaxation as regards the rules regarding a public company's ability to purchase its own shares.[158]

European Union' (2006) 3 European Company and Financial Law Review 178; J Rickford (ed), 'Reforming Capital' [2004] (No 4) *European Business Law Review*. Academic support is also growing in Germany, whose academic community has traditionally been a staunch defender of legal capital rules: F Kubler, A Comparative Approach to Capital Maintenance in Germany" [2004] European Business Law Review 1031.

[147] Modernising Company Law and Enhancing Corporate Governance in the European Union, COM (2003) 284.

[148] Eg the fact that UK plcs cannot accept services as consideration for the payment of shares is said to be detrimental to high tech start ups: Enriques and Macey , (supra n 11) 1195

[149] *Centros Ltd v Erhvervs-og Selskabsstyrelsen* Case C-212/97.

[150] J Simon, "A Comparative Approach to Capital Maintenance: France" (2004) 15 European Business law review 1037.

[151] DTI, Company Law Reform (Cm 6456, March 2005) 42-3.

[152] The idea that the Second Directive should be amended was first raised as part of the "SLIM" initiative (European Commission, Simpler Legislation for the Single Market (SLIM): Extension to a Fourth Phase, SEC (1998) 1944, Brussels, 16 November 1998). It was later added to the agenda for the Commission's High Level Group of Company Law Experts (Report on a Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002).

[153] Eg Some states in the US (most notably Delaware), New Zealand, Australia.

[154] Adoption of the amendment of the second company law directive (July 2006) available at http://ec.europa.eu/internal_market/company/capital/index_en.htm This followed on from a report of the High Level Group of Company Law Experts, *A Modern Regulatory Framework for Company Law in Europe* ('Winter Group, *Report*') ch IV. It is available via http://europa.eu.int/comm/internal_market/en/company/company/modern/#framework

[155] Directive 2006/68/EC of 6 September 2006 amending Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital

[156] Directive 2006/68/EC para 3 states: Member States should be able to permit public limited liability companies to allot shares for consideration other than in cash without requiring them to obtain a special expert valuation in cases in which there is a clear point of reference for the valuation of such consideration. Nonetheless, the right of minority shareholders to require such valuation should be guaranteed.

However, the suggested solvency based approach was not pursued at this point. The review of the Second Directive at European level has not ended there. A study on an alternative to the capital maintenance system of the Second Directive was launched by the European Commission in September 2006, and has now been published.[159] In addition, in a document published in July 2007 the Commission seems to contemplate more radical reform of the Second Directive than has occurred to date.[160] The Commission puts forward two different possible models for how to proceed with a number of company law directives, including the Second Directive, one of which would involve a dismantling of those directives so that the remit of EU regulation in those areas "should be reduced to those legal acts specifically dealing with crossborder problems". This is based on a consideration of the costs that the legal capital measures currently entail[161] and an appreciation that "a rigid, harmonised European framework might sometimes appear to be more of an impediment to innovation than a benefit for the Internal Market".[162] As Charlie McCreevy, European Commissioner for the Internal Market and Services has said: in the ownership structure of the share capital of companies. This possibility should be subject to safeguards, having regard to this Directive's objective of protecting both shareholders and third parties.

"I know that not everyone in the EU agrees with the idea of repealing directives in the area of company law. However, if we want to be serious about making real progress, we cannot accept any taboos. In my view, we need to ask the question whether there is a need for Community rules on domestic mergers and domestic divisions, and whether the EU would not do better to focus on cross-border situations….Even if the result of our considerations is that these directives still serve a legitimate purpose, I really wonder whether the EU needs to go into the level of detail that some of the company law directives currently contain. In my view we must ensure the "less is more" principle is applied in practice."[163] The Commission has invited comment on whether the rules on the capital of public limited companies or at least the capital maintenance system of the Second Directive should be repealed entirely or in parts.[164] The idea that the EU would concern itself with cross border issues but retreat from a more general role in capital regulation is a welcome one. It would allow all Member States to decide how to regulate this issue for themselves. In the UK this would open the way for the present legal capital regime to be dismantled for both private and public companies. In terms of creditor protection, a

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[157] Directive 2006/68/EC Para 5 states: Member States should be able to permit public limited liability companies to grant financial assistance with a view to the acquisition of their shares by a third party up to the limit of the company's distributable reserves so as to increase flexibility with regard to changes

[158] Directive 2006/68/EC para 4 provides: Public limited liability companies should be allowed to acquire their own shares up to the limit of the company's distributable reserves and the period for which such an acquisition may be authorised by the general meetings should be increased so as to enhance flexibility and reduce the administrative burden for companies which have to react promptly to market developments affecting the price of their shares.

[159] The Feasibility Stud is available at http://ec.europa.eu/internal_market/company/capital/index_en.htm. The main conclusion of the study is that the minimum legal capital requirements and rules on capital maintenance do not constitute a major hurdle to dividend distribution.

[160] Communication from the commission on a simplified business environment for companies in the areas of company law, accounting and auditing, COM (2007) 394 final, 10.7.07.

[161] The Commission has also started to measure the administrative burdens in company law throughout the EU: Commission Working Document of 14 November 2006 COM(2006)690 final.

[162] Ibid, p4.

[163] Speech on "Simplification of the business environment for companies at Public event on Better Regulation/Simplification of Company Law with the Portuguese Ministry of Justice, Lisbon, 13 September 2007 available at http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/527&format=PDF&aged=0&language=EN&guiLanguage=en.

[164] Ibid, p6. The Commission launched an external study on the feasilibility of an alternative to the capital maintenance regime of the Second Directive. The results of this external study have now been published (see http://ec.europa.eu/internal_market/company/capital/index_en.htm). The main conclusion of the study (for the purposes of this paper) is that the current minimum legal capital requirements and rules on capital maintenance do not constitute a major obstacle to dividend distribution.

division could then be drawn between the position for solvent companies and the position regarding insolvent companies. As discussed the insolvency rules are effective at protecting the creditors against the claims of shareholders once the company is insolvent, although some thought may be needed as to whether the creditor protection in the twilight zone just prior to insolvency is sufficient. In the UK, directors' duties already impose an obligation to take account of creditors' interests when the company is nearing insolvency, and provisions such as section 214 of the Insolvency Act 1986 already operate in this period. The UK is better placed than many other Member States in this regard. Indeed, the Winter Group suggested a wrongful trading provision akin to section 214 would be desirable throughout Europe should a solvency statement based system be put in place.[165]

It is sometimes suggested that the rules relating to piercing the corporate veil need to be reconsidered in order to allow the creditors on insolvency to claim from the shareholders above and beyond the limit of their contributions to the company. These arguments are not concerned with the need to ensure that the creditors rank ahead of the creditors on a winding up but rather they question whether it is acceptable to undermine the concept of limited liability in some circumstances. The strongest arguments in favour of additional veil piercing are made in relation involuntary creditors.[166] Yet, in the UK compulsory insurance covers the majority of tort claims against companies, namely those arising from accidents at work and road traffic accidents.[167] As regards other forms of tort claim, the victims who claim against companies that subsequently become insolvent are in no worse position than those victims with claims against individuals who are unable to discharge the judgement debt. There is no good justification for altering the veil piercing rules in the UK. So, even if some creditors are not protected against other creditors on insolvency, they are nevertheless protected against the possibility of shareholders ranking ahead of them, which is all that the legal capital rules aim to prevent. As regards the position when the company is undeniably solvent, the argument advanced here is that the justification for the legal capital rules being in place to protect creditors at this point cannot be sustained. Even if some benefit to some creditors can be ascertained as resulting from these rules, which is debatable, the costs of the legal capital regime are likely to far outweigh any potential gain. It is therefore preferable to leave the creditors to protect themselves by contract, where they are in a position to do so.

Some protection may flow to the non-adjusting creditors as a result of free-riding but even if no such protection is present, it is difficult to appreciate why this group is in need of protection while the company remains indisputably solvent, and in any case this group gains no appreciable protection from the legal capital rules. Solvent companies should therefore be left unconstrained by the legal capital rules as regards the manipulation of their own capital. The minimum capital rules for public companies should be removed. There should be an end to par value shares for all companies. Distributions of capital, including dividend payments, reductions of capital, repurchases and redemptions should be dealt with for both private and public companies by way of a solvency-based approach ie providing the company is able to pay its debts for the foreseeable future the directors should be free to make distributions to shareholders, or to manipulate the company's capital in other ways, subject only to the constraints set out below. Financial assistance provisions for public companies would also become open to reform, with the possibility of a solvency based rule governing this issue also. That is not to say that constraints would not exist. Directors would be constrained by the need to gain shareholder approval for the measures and by the need for the directors to comply with their directors' duties

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[165] The Report of the High Level Group of Company Law Experts, *A Modern Regulatory Framework for Company Law in Europe* ('Winter Group, *Report*') ch IV. It is available via http://europa.eu.int/comm/internal_market/en/company/company/modern/#framework

[166] Eg, H Hansmann and R Kraakman, "Towards Unlimited Shareholder Liability for Corporate torts (1991) 100 Yale Law Journal 1879.

[167] Employers' Liability (Compulsory Insurance) Act 1969; Road Traffic Act 1988; Third Parties (Rights Against Insurers) Act 1930.

in proposing and carrying out the measures (ie a standards based approach). In relation to plcs the market will act as a constraint on the company's management. In particular the institutional shareholders within the UK have the potential to act as an important check and balance on management action.

A solvency test approach has already been adopted elsewhere to deal with these issues,[168] and was recommended by the CLR and by the Winter Group. It has already been adopted in the UK to deal with specific aspects of legal capital regulation.[169] However, in order for this approach to be a successful tool in regulating company capital on the wholesale basis set out above it will need careful application. The solvency test itself needs to be carefully defined. What is needed is a test that requires directors to reach a view that for the reasonably foreseeable future, taking account of the company's expected prospects in the ordinary course of business, it could reasonably be expected to meet its liabilities. The test of solvency currently adopted by the Companies Act 2006, in relation to repurchases of shares out of capital by a private company is a good starting point. This test requires the directors to form an opinion about the company's ability to pay its debts at the time of making the solvency statement, and to look forward over the coming twelve months in order to determine whether the company will be able to pay its debts as they fall due over that period (or to pay its debts in full if it is wound up within that period).[170] This test rightly requires directors to take account of "contingent and prospective" liabilities in addition to existing liabilities making this assessment.[171] However, it is generally accepted that directors do not need to consider extraordinary transactions. Drawing this line may not always be straightforward. In order to satisfy the requirement for the formation of an opinion on the ability of the company to pay its debts directors would have to make sufficient inquiries into the financial affairs of the company to satisfy themselves that the statement can be honestly made.[172] A difficult issue is also whether this solvency statement by the directors should be audited. Of the two examples of the solvency statement method at work within the Companies Act 2006

one does require the statement to be audited[173] and the other does not,[174] despite initial recommendations of the CLR to this effect.[175] In practice this distinction is unlikely to be significant since directors are always going to want to get the advice of the company's auditors before making a solvency statement and therefore the auditors will be liable both contract and tortiously if they act negligently. Therefore, although the auditors may not be liable on the face of the statute for negligent advice, the auditors will almost certainly be joined in any action against the directors arising from an inaccurate solvency statement.

The second important component of an effective system based on a solvency statement method is to ensure that directors are made suitably accountable for their solvency statements. Again the solvency statement test currently set out in the Companies Act 2006 provides a starting point. All directors are required to make the statement. Any directors unhappy about making the statement would have to resign or be removed from office before the procedure could

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[168] In some states in the US (eg Delaware), New Zealand and Australia.

[169] Eg as regards the procedure whereby private companies can repurchase their shares from capital (Companies Act 2006, ss709-723, Companies Act 1985, ss 171-177) and the method by which private companies can reduce their capital without going to court (Companies Act 2006, ss 642-644).

[170] Companies Act 2006, s 643(1), cf s 714(3) (regarding repurchases) which encompasses similar ideas, but is expressed in different terms.

[171] Companies Act 2006, s 643(2), s 714 (4).

[172] See *In A Flap Envelope Co Ltd* [2004] 1 BCLC 64 where this test was established in relation to the statutory declaration of solvency for the purposes of the whitewash test in s 155 Companies Act 1985 and see Companies Act 2006, s 714(3) which specifically requires directors to make inquiries.

[173] Companies Act 2006, s 714.

[174] Ibid, s 643.

[175] *Company Formation and Capital Maintenance* (URN 99/1145) para 3.30, although this recommendation was later dropped: *Developing the Framework* (URN 00/656) para 7.26, *Completing the Structure* (URN 00/1335) para 7.9.

be used.[176] If the directors make a solvency statement without having reasonable grounds for the opinions expressed in it, then every director in default commits a criminal offence.[177] The difficulty with imposing a criminal sanction is that, although the aim of imposing criminal liability has the effect of focusing the directors' minds on the issue at hand, over-penalising this issue may not achieve the desired effect. In relation to the criminal liability imposed for breach of the financial assistance provisions for example,[178] the view has tended to be that this is an over-penalisation of the issue and it is the civil consequences of breach which tend to be focussed on in practice. If criminal provisions are rarely or never enforced it may be questioned how much deterrent effect they will in fact have. An alternative mechanism would be to adopt an approach similar to that in relation to section 214 Insolvency Act 1986 whereby "the court … may declare that [the director] is to be liable to make such contribution (if any) to the company's assets as the court thinks proper".[179] However, this liability is not without difficulty either. Often directors of insolvent companies will have few personal assets available to satisfy such claims, either because they have invested their personal wealth into the company or because they have been carefully advised to place their assets elsewhere to protect them. To the extent that D & O insurance is available to fill the gap the cost of such insurance falls on the company, and will presumably be passed on to the shareholders and creditors, ie those whom the protection is intended to benefit, and to the extent that payments are made out of insurance policies rather than the directors own pockets, the deterrent effect of such liability must be weakened. Of course liability under the Company Directors Disqualification Act 1986 will potentially fall on the directors for their behaviour but it is unclear whether this will, of itself, provide the deterrent required.

The third important component of such a system is to ensure that effective mechanisms for the recovery of wrongful payments are put in place. The current solvency tests in place within the Companies Act 2006 do not provide a good basis for the determination of this issue. The Companies Act 2006 is silent on the civil consequences of a distribution to shareholders paid consequent upon a false or inaccurate solvency statement. There is case law to the effect that an unlawful return of capital is void[180] and this is so even where the failing is purely procedural, so it is likely that a flawed solvency statement would invalidate a distribution in a similar manner. In addition the common law has established that the responsible directors are in breach of their duties to the company.[181] However, in order for the solvency statement method to operate as an effective way of protecting the company's capital, an effective system of ensuring that the wrongful payments are returned to the company should be put in place. The present position regarding dividends is clear: recipients are only liable to repay if they know or have reasonable grounds for believing that the payment is made unlawfully.[182] Recipient liability for other forms of distribution to shareholders is dealt with by the common law, but the position is the same. This seems to be an inappropriate way of dealing with this issue. There should be strict liability on those receiving wrongful payments, requiring those payments to be returned, with relief only if the recipients are in good faith, they have changed their position and if it would be unfair to insist upon recovery. There are strong theoretical arguments in favour of such an

[176] If such a resignation is done merely for the purposes of the resignation and the individual continues as a de facto director then this might call into question the validity of the solvency statement procedure: *In A Flap Envelope Co Ltd* [2004] 1 BCLC 64 (in relation to s 155 Companies Act 1985).

[177] Companies Act 2006, s 643(4)(5), s 715.

[178] Companies Act 2006, s 680, (Companies Act 1985, s 151(3)). The CLR considered decriminalizing this offence (Completing the Structure (URN 00/1335), para 13.42) but after receiving mixed views on this point it eventually recommended retention of the criminal sanctions.

[179] Insolvency Act 1986, s 214(1); *Re Produce Marketing Consortium Ltd (No 2)* [1989] BCLC 520.

[180] *MacPherson v European Strategic Bureau Ltd* [2000] 2 BCLC 683.

[181] *Aveling Barford Ltd v Perion* [1989] BCLC 626.

[182] Companies Act 2006, s 847(2). This means knowledge of the facts giving rise to the contravention. It is not necessary for the recipients to appreciate that the payment involves a contravention of the Companies Acts: *It's A Wrap (UK) Ltd v Gula* [2006] BCC 626.

approach rather than the present knowledge-based system which results in very few payments being recovered from the shareholders in practice.[183] There are also strong policy arguments available to support this approach, since the purpose of these rules is creditor protection and that is best served, if the rules are breached, by ensuring that the wrongfully paid sums are returned to the company for the benefit of the creditors. It is notable that in other jurisdictions that have adopted a solvency based approach, a much tougher statutory approach towards recipients of wrongful payments has been adopted than is present in the UK system.[184]

2) **Решите задачу.**

По итогам открытого конкурса между ОАО «1» (далее Заказчик) и ОАО «2» (далее Исполнитель) 7 декабря 2010 года был заключен договор, по которому исполнитель обязался выполнить комплекс работ по разработке конструкторской документации, изготовлению и поставке оборудования и передать результаты работ заказчику, который в свою очередь обязался принять и оплатить выполненные работы. Указанный договор осуществлялся сторонами в рамках Инвестиционного Проекта, в котором участвовали и другие коммерческие организации.

В соответствии с договором и Дополнительным соглашением № 1 сроки выполнения работ и поставки оборудования определялись в спецификации (приложение № 1 к договору), а изготовление оборудования производилось исполнителем по этапам, указанным спецификации.

14 мая 2012 г. по результатам проведенного совещания участников Инвестиционного Проекта был составлен протокол по вопросам разработки, изготовления, поставки и монтажа оборудования в рамках Проекта. В Протоколе закреплено решение о внесении изменений в проектную документацию, а также изменение сроков выполнения работ в рамках Проекта. Протокол подписан всеми участниками совещания, в том числе со стороны Заказчика заместителем генерального директора по капитальному строительству и заместителем главного инженера, а со стороны Исполнителя генеральным директором.

В соответствии с п. 11 договора исполнитель выплачивает заказчику пеню в размере 0,1% от общей стоимости невыполненных в срок работ за каждый день просрочки.

В порядке досудебного урегулирования спора Заказчик направил Исполнителю претензию от 01.02.2013 г. о выплате пени за просрочку поставки оборудования по состоянию на январь 2013 г. и просил выполнить все работы по договору в срок до 15.02.2013 года. Исполнитель в ответ на претензию указал, что просрочка в выполнении работ и поставке оборудования была вызвана задержкой со стороны Заказчика в предоставлении Исполнителю исходных данных по договору, а также в рамках исполнения договора некоторые исходные данные Заказчиком изменялись, что повлекло необходимость внесения изменений в компоновочные решения и увеличение сроков изготовления оборудования. При этом в соответствии с п. 5.1.2. договора Заказчик обязан обеспечить предоставление Исполнителю исходных данных для выполнения работ. Исполнитель также указывал, что впоследствии поставка осуществлялась в соответствии с графиком, утвержденным на совещании участников Инвестиционного Проекта.

Оцените ситуацию и доводы сторон. Выскажите мнение о том, как должен решить данное дело суд, в случае обращения Заказчика с исковым заявлением в арбитражный суд о взыскании пени по договору.

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[183] J Payne, “Unjust Enrichment, Trusts and Recipient Liability for Unlawful Dividends” (2003) 119 LQR 583.
[184] Eg New Zealand see Companies Act 1993, s 56(1).

МЕТОДИЧЕСКИЕ РЕКОМЕНДАЦИИ

1. Для выполнения первого задания необходимо руководствоваться следующим:

1) Разрешается пользоваться словарем (только печатным изданием).

2) Объем выполненного задания должен быть небольшим – 3-5 страниц. Текст должен быть написан грамотно и приемлемым почерком.

3) Анализ статьи необходимо начать с перевода ее названия. Это поможет понять главную проблему статьи и ключевые термины, используемые в статье.

4) Прочитав статью, необходимо сформулировать и кратко описать главную проблему(ы), которой она посвящена. Следует обязательно высказать собственную позицию по затронутой автором статьи проблеме, ее обосновать и привести аргументы. Для выполнения задания недостаточно просто описать рассматриваемые автором вопросы.

5) Критериями оценивания первого задания являются:

а) способность к критическому анализу затронутой в статье проблемы

б) степень аргументированности и обоснованности;

в) ясность и точность формулировки личной позиции;

г) корректность перевода и использования понятийного аппарата, адекватное применение переведенных терминов и понятий.

2. При решении задачи, необходимо:

1) дать правовую оценку изложенной в задаче ситуации и доводам сторон;
2) сформировать аргументированную позицию по следующим вопросам:
   1. Какое правовое значение и при каких условиях, может иметь Протокол, подписанный на совещании всеми участниками Инвестиционного Проекта, в том числе и лицами, являвшимися сторонами договора?
   2. Применяется ли в изложенной в задаче ситуации ст. 328 ГК РФ?

Удачи!