

Alternative systems for capital protection



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This study of alternative systems for capital protection has been carried out on the instructions of the Scientific Research and Documentation Centre (Wetenschappelijk Onderzoek- en Documentatiecentrum, or WODC) of the Ministry of Justice on behalf of the Legislation Department.

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Summary

This study of alternative systems for capital protection has been carried out on the instructions of the Scientific Research and Documentation Centre (Wetenschappelijk Onderzoek- en Documentatiecentrum, or WODC) of the Ministry of Justice on behalf of the Legislation Department. The three researchers, H.E. Boschma, M.L. Lennarts and J.N. Schutte-Veenstra, all affiliated to the Institute for Company Law in Groningen, carried out the study from 1 November 2004 to 1 July 2005.

The purpose of the study is to establish whether the existing system of capital protection applicable to public companies [in Dutch *naamloze vennootschappen* or NVs] and private companies [in Dutch *besloten vennootschappen*, or BVs] can be abolished and replaced with a different system without reducing the level of protection for creditors and shareholders. The reason for this is that the current capital protection provisions exceed their purpose (the protection of creditors and shareholders) and involve unnecessary costs for businesses. In connection with the review of the capital protection regime, part of the study considers whether the nominal value of shares should be abolished and no par value shares (NPV shares) should be introduced.

The method chosen to enable alternative solutions for the present system of capital protection to be presented is a comparative legal study. The sources used are legislation, literature and case law; certain experts from the legal systems investigated were also consulted. These legal systems are those of Australia and the United States state of Delaware. The Revised Model Business Corporation Act (RMBCA), a model act drawn up by the American Bar Association, was also studied. This model act has been followed on many points in various states of the United States of America. With this choice of legal systems, an attempt has been made to give a representative picture of the possibilities offered by foreign legal systems for alternative legislation for the protection of – mainly – corporate creditors.

The study was carried out using certain questions grouped around three themes: creditor protection (contributions by and distributions to shareholders), shareholder protection, and the introduction of NPV shares. The results for each legal system are given in three Country Reports enclosed as attachments, as are the texts of the statutory provisions discussed in these Country Reports. The report itself contains an integrated treatment of the results of the study and the conclusions and recommendations derived there from. The report also contains a matrix showing the results of the study in diagram form.

The main conclusions regarding the consideration for shares are that the three systems do not prescribe any minimum payment requirement for shares; there is no minimum requirement for the amount of the issued and/or paid-up capital; the board of directors is authorised to both issue shares and set the issue price of the shares; there are no limitations regarding the form of any consideration in kind and there is no statutory requirement for a consideration in kind to be valued by an independent expert.

The researchers take the view that there are good reasons to abolish the provisions for the raising of the capital of public and private companies. These provisions overreach their objective, the protection of creditors, and moreover they impose unnecessary costs on businesses. This means that the minimum capital requirement, the provisions regarding the payment obligation on shares (statement of the bank that cash consideration is paid and the valuation of a consideration in kind by an independent expert), and the ‘Nachgründung’-provision (company acquiring assets belonging to founders of the company) will disappear. The prohibition on the contribution of an undertaking to perform work or supply services can also be repealed. The risks associated with the contribution of work or services in the future will have to be calculated for in the determination of the economic value of such considerations.

The main conclusions regarding distributions to shareholders are that in the three legal systems studied the board of directors is the body authorised to make distributions; the criterion for making a distribution of dividend differs in each system (RMBCA: a combination of a liquidity test and a variant of the balance sheet test; Delaware: a (stricter) balance sheet test; nimble dividends allowed; Australia: a profits test and a liquidity test; nimble dividends allowed); only the RMBCA sets an actual limit on the various distributions to shareholders; the creditors have additional protection against damage through distributions to shareholders, mainly from the fraudulent transfer rules in the US and the insolvent trading provision in Australia; the purchase provision in two of the three systems is limited to prescribing a criterion for payment of the acquisition price of the company’s own shares; a liquidity test applies in both Delaware and Australia for a capital reduction, and finally that only in Australia a special statutory regulation for financial assistance applies.

The main recommendations regarding distributions to shareholders are: that a simple balance sheet test and a liquidity test should be carried out, directors may only move to pay such

distributions after they have explicitly stated that these tests have been met; a limit should apply regardless of the way in which the distribution is made; various financial reporting standards can be applied for the implementation of the balance sheet test; the 10% limit in the purchase regulation can be either repealed or significantly lowered; creditors' right to object to a capital reduction can be abolished together with the separate statutory regulation regarding the giving of financial assistance to third parties for the acquisition of the company's own shares.

Lastly, it has become clear that the term nominal value is relative; it has no standard value. Abolition of the nominal value of shares will however affect other issues besides the capital protection provisions. The nominal value is often used as a criterion, for instance to determine the voting rights and rights to profits of shareholders. The study shows that the criterion of the nominal value can be quite easily replaced by various other criteria. Moreover, what emerged as the most compelling argument for abolition of the nominal value is that the misleading picture that it gives will be avoided. It appears that shares have a particular value, whereas in most cases this does not correspond with reality. Legislation should be as simple and clear as possible. Terms that do not have any distinct meaning should be avoided. For this reason we recommend the introduction of NPV shares. If this is to be adopted, it would be best if it were to be made mandatory. The Dutch legislator can realise this for private companies (BV). The introduction of NPV shares for the public company (NV) is, however, only possible if the Second EEC Directive is amended. It is conceivable that, after such an amendment, the two systems: PV shares and NPV shares, will continue to exist alongside each other. The fact that this is perfectly possible is shown by the company law of Delaware.

1. Introduction

1.1. Developments in capital protection law

1.1.1. Criticism of the current capital protection regime

Dutch law regarding public and private companies has a strict capital protection regime. The main pillar of this regime is the capital of the company, which is divided into shares with a nominal value. In principle, this nominal value corresponds with the payment requirement for shareholders. The payment requirement for shares is the subject of the first category of the provisions of the capital protection law. These include the minimum capital requirement, the requirement of a payment of at least 25% of the nominal value of the acquired shares, the requirement that a consideration in kind must have an economic value that can be established, as well as the provisions regarding the check on considerations in cash and in kind, which must be accompanied by a bank statement or an auditor's statement, respectively.

Besides the provisions regarding the raising of capital, the capital protection law also has provisions relating to the maintenance of capital. For this second category of capital protection provisions, not only the capital itself is important, but also the reserves stipulated by law and the articles of association. These reserves, together with the paid-up and called-up capital, are known as the tied-up assets. These assets may not be reduced by distributions to shareholders, regardless of the method used: (interim) dividend, purchase of own shares, repayments with capital reduction. The reason is that the tied-up assets have to provide recourse to creditors and erosion of them would weaken their position. Book 2 of the Dutch Civil Code [BW] therefore includes strict rules preventing erosion of the tied-up assets through distributions to shareholders.

There has been much criticism of the statutory provisions of capital protection¹, both of individual provisions of the capital protection law and of the system of capital protection. The provisions of capital protection are not always simple to interpret, they are sometimes too strict (the legislation contains a lot of imperatives and little in the way of regulation), sometimes they are self-contradictory and some provisions are easy to evade. From a more principled point of view, the criticism is that the system of capital protection does not offer adequate

¹ See among others the special issue of the Tijdschrift voor Insolventierecht (Tvl): *The liquidator and capital protection* of November 2003 and the contributions of Ophof and Winter in *Problems in company law*, part 24 IVO-series, Deventer: Kluwer, 1995.

protection to creditors and places unnecessary obstacles for public and private companies in the way they run their business.

1.1.2. Developments in the law on private companies

Initiatives have recently been made to simplify and add flexibility to the Dutch law on private companies. An important part of this operation concerns capital protection law. Reference can be made to the report titled 'Relaxation of the capital protection law applicable to private limited companies' ['Versoepeling van het BV-kapitaalbeschermingsrecht'] by M.L. Lennarts and J.N. Schutte-Veenstra, of 31 March 2004, which was the result of a study carried out on behalf of the Ministry of Economic Affairs. This was a comparative legal study of alternative solutions to the strict capital protection regime applicable to private companies. Furthermore, the Expert Group for simplifying and adding flexibility to BV law was set up on the initiative of the Minister of Justice and the State Secretary of Economic Affairs. In its final report, titled 'Simplification and flexibilisation of Dutch private company law' ['Vereenvoudiging and Flexibilisering van the Nederlandse BV-recht'] of 6 May 2004, the Expert Group, using and building on the former report mentioned above, put forward proposals for revision of the capital protection law of private companies (chapter 4, p. 75-95)² which formed a source of inspiration for a bill to be put before the Dutch Parliament designed to simplify and add flexibility to private company law. The first part of this bill was published as a legislative proposal on the websites of the Ministries of Justice and Economic Affairs³ on 10 February 2005. The second part was published on 20 July 2005.

1.1.3. European legal implications for capital protection law for public companies

The capital protection regime for public companies is stricter than that for private companies. Here there is also a need for change, although unlike private company law, in this case the initiative has to come from the EU. Public company capital protection law is laid down in Book 2 BW for implementation of the Second EEC Directive.⁴ The Dutch legislator has to

² Both reports cited are published on the websites of the Ministry of Economic Affairs and Ministry of Justice. See www.flexbv.ez.nl and www.justitie.nl/themas/wetgeving/dossiers/bv-recht/index.asp respectively.

³ See www.minjus.nl/themas/wetgeving/dossiers/bvrecht/consultatie.asp and www.ez.nl/content.jsp?objectid=30432 respectively.

⁴ Directive 77/91/EEC, [1977] OJ L 26/1

remain within the boundaries specified in this directive when changing capital protection rules for public companies, which leaves very little room to manoeuvre.

Changes to the capital protection regime are being advocated in other EU member states as well as in the Netherlands, for example the process of reforming company law in the United Kingdom. The Company Law Reform Steering Group set up for this purpose has published various consultation documents, some of which concern capital protection law. Reactions have shown that there is a pressing need for changing the capital protection regime for public limited companies (plcs). There is wide support for a proposal to introduce shares with no nominal value. The provisions of the Second EEC Directive however stand in the way of this being implemented.⁵ The report of a group of experts chaired by Jonathan Rickford, which proposes a radical reform of capital protection law: 'Reforming capital: report of the interdisciplinary group on capital maintenance'⁶, is also of interest in this connection. A White Paper titled 'Company Law Reform' was published in the UK in March 2005.⁷

1.1.4. Criticisms of the Second EEC Directive

More than 25 years after its appearance, the capital protection provisions in the Second EEC Directive are open to various criticisms, some of which are:

- The minimum capital requirement provides only very limited protection to creditors. First, the amount of EUR 25,000 of minimum capital specified in art. 6 is arbitrary. This amount of starting capital would not be sufficient for many business operations. Second, a minimum capital requirement only has meaning if the amount paid up for the shares is still actually available in the assets of the public company at the time that the creditor wishes to be paid for the goods or services supplied. There is no guarantee whatsoever that this will be the case. The creditor requires settlement of his claim. In other words, the liquidity of the public company in the short and long term needs to be sufficient to settle the claims of its creditors. The minimum capital requirement falls short in this respect, and gives creditors only the appearance of security.

⁵ See *Modern Company Law for a Competitive Economy - The Strategic Framework*, par. 5.4.26 - 5.4.33 and *Modern Company Law: Completing the Structure*, par. 7.3.

⁶ Published in *European Business Law Review* 2004, Volume 15, issue 4.

⁷ To be found at <http://www.dti.gov.uk/cld/review.htm>. See 4.8 Capital maintenance and share provisions.

- There is a situation of over-regulation, in which provisions are not workable in practice. Examples of this are the ‘Nachgründung’-provision; the provision in respect of the acquisition of assets from a company’s founder within two years of the company’s formation (art. 11) and the provision on the giving of financial assistance to third parties for the acquisition of the company’s own shares (art. 23). From the point of view of easing the burden on business, these rules have to be simplified.
- The system of capital protection is inconsistent, since the making of distributions (dividend, purchase; art. 15 and 19) is linked with the condition of sufficient free assets, while the granting of loans to third parties who thereby acquire shares in the company is completely prohibited.
- The making of distributions to shareholders is linked to having sufficient free distributable equity. Whether this condition is met has to be determined on the basis of the information in the latest adopted annual accounts. Being bound to the information in the annual accounts causes problems.⁸ The data in the annual accounts are outdated at the time the decision is made regarding distributions to shareholders. The valuation principles vary as well. Under capital protection law, only actually realised profits can be included when establishing the amount available for distribution, while in international accounting standards the realisation principle is increasingly being abandoned in favour of valuation at fair value. Furthermore, the already partly implemented International Financial Reporting Standards (IFRS) take no account of capital protection and therefore have no rules for the treatment of reserves.
- Creditors’ right to object to a capital reduction (art. 32) is ineffective in international relations, since foreign creditors usually are unaware of any announcement of a capital reduction.⁹
- The Second EEC Directive leaves the appropriation of the share premium unregulated. In some member states, share premium received is included in an undistributable reserve (UK, Germany); in other member states the share premium reserve is freely distributable (the Netherlands, France, Italy, Spain). This difference affects all provisions regarding capital maintenance, and therefore the level of capital protection within the EU varies.

⁸ See the preliminary report of H. Beckman for the Vereeniging Handelsrecht (Dutch Trade Law Association) in 2003: *Jaarrekening en kapitaalbescherming (Annual Accounts and Capital Protection)*, p. 3-64.

⁹ Compare J.N. Schutte-Veenstra, ‘Enkele kanttekeningen bij het vennootschappelijk verzetrecht van crediteuren’ (‘Some notes on corporate creditors’ right to object’), *TVVS* 1996, p. 293-298.

Besides these criticisms of the rules of capital protection as laid down in the Second EEC Directive, fundamental doubts have been expressed regarding the usefulness of the system of capital protection it supports. The origin of the financial assets – the payments made by the shareholders for the shares – should not be the determining factor when answering the question of whether a company may make distributions to its shareholders. Such a regulation does not meet the need of creditors for protection, that the company will be able to pay its debts as they fall due.¹⁰ The criterion should be whether there are sufficient financial assets available.

The importance of capital protection law has also been put into perspective in case law. At national level, one can refer to the *Nimox* judgment,¹¹ in which the Dutch Supreme Court decided that even though a company had taken the capital protection provisions into account when making a distribution to its shareholders, such distribution could still be unlawful vis-à-vis third parties, such as the company's creditors. At European level, we have the *Centros* judgment by the European Court of Justice¹², in which the importance of the minimum capital requirement for the protection of creditors was seriously weakened. The Court stated that creditors could have been aware that they were doing business with a foreign company that was subject to a different legal system. They were also protected by the publication requirements of the Fourth and Eleventh EEC directives. They could therefore have found out that the company in question had very little capital, so that if they wished they could have taken measures to protect their interests.¹³ In its more recent *Inspire Art* judgment, the Court followed the same reasoning.¹⁴

¹⁰ See P. van Schilfgaarde, 'De Besloten Vennootschap naar het recht van de Nederlandse Antillen' ('The Private Company under the law of the Netherlands Antilles'), *Ondernemingsrecht* 2000, p. 33, which observes that a company has never gone bankrupt because it failed to take the capital protection provisions into consideration.

¹¹ HR 8 November 1991, *NJ* 1992, 174.

¹² ECJ 9 March 1999, Case C-212/97 [1999] *ECR* p. I-1459.

¹³ Compare paragraph 36: "Since the company concerned in the main proceedings holds itself out as a company governed by the law of England and Wales and not as a company governed by Danish law, its creditors are on notice that it is covered by laws different from those which govern the formation of private limited companies in Denmark and they can refer to certain rules of Community law which protect them, such as the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (OJ 1978 L 222, p. 11), and the Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State (OJ 1989 L 395, p. 36)." See also L. Timmerman, 'Van digitaal naar analogo vennootschapsrecht en de gevolgen daarvan voor de concurrentie tussen vennootschapssystemen' ('From digital to analog company law and the consequences thereof for competition between corporate law systems'), *Ondernemingsrecht* 2003, p. 41.

¹⁴ ECJ 30 September 2003, Case 167/01 [2003] *ECR*, p. I-10155, paragraph 135: "First, with regard to protection of creditors, and there being no need for the Court to consider whether the rules on minimum

1.1.5. Initiatives at European level

At European level, there has already been a first move towards amending the Second EEC Directive. As part of the SLIM initiative¹⁵ undertaken by the European Commission, a report was published in the autumn of 1999, which contained proposals for its simplification.¹⁶ The SLIM working group proposed the following amendments: the introduction of two exceptions relating to the mandatory valuation of considerations in kind; the addition of a buy-out regulation; simplification of the purchase regulation and the financial assistance provision and the allowance of an exception regarding the pre-emptive rights of shareholders if new shares were issued at the market price. The assignment of the SLIM working group was to report on possible ways of simplification. This limitation meant that proposals for a fundamental review of public company capital protection law were not possible; therefore the SLIM working group could only state that further study was necessary to determine whether the issue of shares without nominal value should be permitted in order to simplify public company law.

Subsequently, in September 2001, the European Commission set up the High Level Group of Company Law Experts (the Winter Committee). The Winter Committee's duties included making recommendations for modernising company law in the EC member states. After a consultation document was published on 25 April 2002, the Winter Committee presented its final 165-page report on 4 November 2002: 'A Modern Regulatory Framework for Company Law in Europe'.¹⁷ Regarding capital protection law, the Committee recommended that the Second EEC Directive should be simplified in the near future on the basis of the recommendations of the SLIM working group, with some additions (SLIM-Plus). An alternative regime for creditor and shareholder protection should then be presented based on abolition of the concept of issued capital. An important element of this alternative regime

share capital constitute in themselves an appropriate protection measure, it is clear that Inspire Art holds itself out as a company governed by the law of England and Wales and not as a Netherlands company. Its potential creditors are put on sufficient notice that it is covered by legislation other than that regulating the formation in the Netherlands of limited liability companies and, in particular, laying down rules in respect of minimum capital and directors' liability. They can also refer, as the Court pointed out in *Centros*, paragraph 36, to certain rules of Community law which protect them, such as the Fourth and Eleventh Directives."

¹⁵ The abbreviation SLIM stands for Simpler Legislation for the Internal Market.

¹⁶ See E.E.G. Gepken-Jager and J.N. Schutte-Veenstra, 'Voorstellen SLIM-werkgroep ter vereenvoudiging van eerste en tweede EG-richtlijn' ('Proposals of SLIM working group on simplifying the First and Second EEC Directives'), *Ondernemingsrecht* 1999, p. 423-425.

¹⁷ The text of the final report of the Winter Committee can be found on the EU website: http://www.europa.eu.int/comm/internal_market/and/company/company/modern/index.htm.

should, according to the Winter Committee, be the linking of distributions to shareholders to a 'solvency test'.

Partly in reaction to the report of the Winter group, the Commission published a 'Company Law Action Plan'¹⁸ on 21 May 2003, indicating that the European regulatory framework for company law and corporate governance should be updated and improved. As part of this, the Commission proposed to put forward proposals in the short term (2003-2005) for simplifying the provisions of the Second EEC Directive regarding capital protection. In execution of this, the Commission published a proposal¹⁹ for a directive to amend the Second EEC Directive on 29 October 2004²⁰, in which the current capital protection provisions were simplified. It offered member states the possibility of introducing certain exceptions to the mandatory valuation of consideration in kind in art. 10; the regulation for purchase of the company's own shares in art. 19 was eased and the giving of financial assistance by the company to a third party for the acquisition of its shares was, subject to conditions, made possible.

The proposed changes leave the pillars of the current capital regime in place. Amendments have only been made in certain parts. In the Company Law Action Plan the Commission also lets it be known that the introduction of an alternative regime for creditor protection not based on the concept of issued capital, for example the introduction of shares without nominal value, is to be addressed in the medium to longer term (2006-2008). A feasibility study must be carried out first.

1.2. Purpose and content of study

1.2.1. Purpose of study

This study has been carried out on the instructions of the Research and Documentation Centre (Wetenschappelijk Onderzoek- en Documentatiecentrum, or WODC) of the Ministry of Justice on behalf of the Legislation Department. It focuses on answering the question of whether the

¹⁸ In full: Communication from the Commission to the Council and the European Parliament – Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward (COM (2003) 284 final), 21 May 2003, to be found at http://www.europa.eu.int/comm/internal_market/company/company/modern/index.htm.

¹⁹ The text of the change proposal can be found at www.europa.eu.int/comm/internal_market/company/capital/index_and.htm.

²⁰ See J.N. Schutte-Veenstra, 'Voorstel tot vereenvoudiging van de tweede EEG-richtlijn' ('Proposal for simplifying the Second EEC Directive'), *Ondernemingsrecht* 2004, p. 680-682.

existing system of capital protection can be abolished and replaced without reducing the level of protection for creditors and shareholders. One option is to offer an alternative system that could function alongside the existing system, which could, but not necessarily, be based on abolition of the nominal value of shares.

Broadly speaking, shares without nominal value (known as no par value shares or NPV shares) appear in two forms. The first are shares with a fraction value. They have no explicit nominal value, but they do represent a certain portion of the issued capital. Unlike the nominal value of a share, which is established when issued and basically does not change (apart from increases or decreases to par value or stock splits or reverse splits), the fraction value of a share has to be calculated. The general rule in the calculation of this 'theoretical' nominal value is that the total issued capital of the company is divided by the total number of issued shares. The fraction value of a share therefore is equal to the percentage of the issued capital that it represents at any given time, and is therefore subject to fluctuations. In systems within the EU in which fraction shares appear, creditor protection is regulated by provisions for the raising and maintenance of the capital of the company, as specified in the Second EEC Directive.

The second form of shares with no nominal value concerns real no par value shares. The value of a share is no longer related to the size of the company's issued capital; there is no direct relationship between the number of shares and the issued capital. Real no par value shares have no clearly indicated value; they represent a percentage of the value of the company ("net worth/value of a company's undertakings"), which can vary from day to day. Introduction of real no par value shares usually leads to other forms of creditor protection, such as publication requirements (solvency declaration) and liability provisions for shareholders, directors and policy-makers.

The central issue in assessing the introduction of an alternative system is how creditors and shareholders of a company are to be protected against damage to their position, and whether this protection is adequate.

1.2.2. Method

The method whereby we can come to a simplification of the current system of capital protection and offer alternative solutions is to carry out a comparative legal study. There are legal systems, which have other regulations to protect creditors either instead of or alongside capital protection provisions. These regulations vary between two extremes. The greatest deviation from the current capital regime occurs in countries where shares with no nominal

value are issued. Creditors here are protected against non-payment of their claims by their debtor companies through measures such as publication requirements and liability provisions (for example in cases of wrongful trading). In other countries we find less difference. The nominal value of the shares is the basic principle; the provisions however are significantly more flexible on certain points.

The sources consulted are legislation, literature and case law. Certain experts from the legal systems investigated were also consulted (in Australia, officials of the Australian Treasury in co-operation with employees of ASIC, the regulator; in the United States, lawyers active in insolvency practice). They answered many of the researchers' questions, which mainly concerned clarifications and additions to the study of legislation, literature and case law in the legal system concerned. Little or no information however was available on the practical application of alternative systems for capital protection. A much more extensive study would have to be set up for this, for example through surveys of company directors and insolvency specialists.

1.2.3. Legal systems studied

The legal systems studied are those of Australia and the United States state of Delaware. The Revised Model Business Corporation Act (RMBCA), a model act drawn up by the American Bar Association, was also studied. This model act has been followed on many points in various states of the United States of America.

The legal systems chosen had to be in countries outside the EU. In the EU, national legislation on public limited liability companies has to be in accordance with the provisions of the Second EEC Directive. This is not the case for the law on private limited liability companies, but the Second EEC Directive has affected the capital protection law applying to private companies, either intentionally or unintentionally. In some member states there has been imitation, in the sense that the capital protection regime of the private company has been amended on many points in connection with the implementation of the Second EEC Directive in respect of public companies. This occurred for instance in the Netherlands, Belgium, Denmark and Italy. In other member states this was not the case, but the Second EEC Directive has nevertheless influenced the legislation on private companies, for example in the UK. There is no minimum capital requirement for private companies, but the provisions regarding distributions to shareholders and associated legal transactions are heavily influenced by the provisions of the Second EEC Directive.

The legal systems of Australia, Delaware and the RMBCA have been used in the study. Australia was chosen because the nominal value of shares was abolished fairly recently here (1998). The reasons for this and the amendments necessary in company legislation as a result of the abolition can therefore be clearly identified. Company law in the state of Delaware is considered to be leading and therefore could not be omitted. It is also an interesting point that under Delaware law a company can issue shares both with and without nominal value.²¹ Finally, the RMBCA was studied because of the extensive influence this model act has had on the company law of many other US states.

With the choice of legal systems, an attempt has also been made to give a representative picture of the possibilities offered by foreign legal systems for alternative regulation for the protection of corporate creditors. Such alternative regulation can occur in both systems where shares have a nominal value and where nominal value has been abolished. For this reason, it was decided to describe a legal system which only permits real no par value shares in combination with provisions for capital protection (Australia); a legal system that is based on the issue of real no par value shares but in which the issue of par value shares is not prohibited (RMBCA); and a legal system which allows the company to issue shares with or without nominal value or a combination of the two (Delaware).

1.2.4. Questions grouped by theme

A comparative legal study has been made of the three above-mentioned legal systems, using a number of questions grouped around three themes: creditor protection, shareholder protection and the implementation of NPV shares. In the Country Reports enclosed with this report as attachments, the questions are preceded by an introduction to each legal system, giving the main features of the system in question and a brief historical survey.

The themes and questions were arrived at on the basis of a number of focus points in the study. First, it is important to establish which provisions in the legal system concerned contribute to protection of the interests of creditors. These concern provisions relating to the payment for shares and the making of distributions to shareholders, but also publication requirements and liability provisions.

²¹ See § 151 DGCL.

We have included aspects of shareholder protection as well as creditor protection, for two reasons. Some of the capital protection provisions are part of the protection of the interests of shareholders, such as the prohibition of share issues below par and pre-emptive rights in a share issue. The second reason is that part of the study concerns the advantages and disadvantages of introducing NPV shares. The term nominal value is important for the position of the shareholders. The nominal value is in principle the determining factor for the voting rights and rights to profits attached to a share. Furthermore, the nominal value is the starting point when establishing the issue price of a share. The nominal value of a share also affects the setting of thresholds for decision-making at the GMS, such as requirements relating to a majority of votes and a quorum. Finally, the nominal value of a share is used as a criterion for determining whether one or more shareholders can establish claims or make certain requests. Any abolition of the nominal value would mean that another criterion would have to be established for all these issues. Ideas for this can be obtained from the legal systems studied. A third theme concerns the introduction of NPV shares. It needs to be considered whether there were specific problems involved in the introduction of NPV shares in the respective foreign legal systems, so that these could be avoided in the event of such an introduction in the Netherlands. Further, it is considered whether a company can simultaneously issue shares with and without nominal value, and under what conditions a conversion of both types of share would be possible.

1.2.5. Concrete study questions

The discussion of the three foreign legal systems is based on the list of questions given below.

A. Introduction

What are the main features of company law in the system concerned? This includes a short description of the system and a brief historical survey.

B. Creditor protection

Payment for shares

1. What body is authorised to issue shares and set the issue price?

What forms of consideration may be used for payment for shares? Who determines their value? Must the valuation take place at the time of actual contribution, or may another date be used?

2. Can a deferred payment be agreed?
3. How are the share capital and payments on shares reported in the balance sheet?

Distributions to shareholders

4. Are there any capital maintenance rules? If so, what are they?

Divided into:

- (interim) dividend distributions
- purchase of own shares
- financial assistance for the acquisition of the company's own shares by a third party
- capital reduction and associated legal transactions

Other

5. What publication requirements have an actual effect on creditor protection?
6. What other (liability) provisions contribute to creditor protection?

C. Shareholder protection

1. How are the voting rights and rights to profits (voting and dividend rights) of shareholders determined?
2. How are the rights of existing shareholders protected in the event of share issues? Are there pre-emptive rights, either statutory or in the articles of association?
3. What minority rights does the system contain? What is the determining criterion for establishing certain claims or making certain requests by shareholders? Compare in the Netherlands the right of inquiry, the regulation of disputes, the squeeze-out procedure and the legal authority to convene a GMS.
4. What thresholds – voting majority and quorum requirements – are used for decision-making by the GMS?

D. Introduction of NPV shares

1. Did the introduction of NPV shares give rise to specific problems? If so, how were they solved?
2. Do NPV shares otherwise lead to specific problems?
3. Does the simultaneous existence of shares with and without nominal value lead to specific problems?

4. Under what conditions is a conversion of shares with nominal value into NPV shares possible?

5. Under what conditions is a conversion of NPV shares into shares with nominal value possible? How is the nominal value per share calculated in such cases?

1.2.6. Design of report

The discussion of the answers to the questions in item 1.2.5. for each legal system are given in the Country Reports enclosed with this report as attachments, as are the texts of the applicable statutory provisions.

The essence of the results of the study is contained in this report. The most attention is devoted to aspects of creditor protection (chapter 2). Chapter 3 deals with aspects of shareholder protection and the possible abolition of the nominal value of shares. Chapter 4 contains conclusions and recommendations. An overview of the study results is given in the matrix.

2. Aspects of creditor protection

2.1. Consideration

2.1.1. Nominal value of shares

Since 1980 the RMBCA assumes that no par value-shares (NPV shares) are issued, but the issue of par value shares (PV shares) is not prohibited (§ 2.02 (b) (2) (iv) RMBCA). Under the laws of Delaware, companies may issue shares both *with* and *without* nominal value (§ 151 DGCL). In Australia, only NPV shares may be issued. The nominal value of shares was abolished by the Company Law Review Act 1998 (Act No. 61, 1998, s. 254 CA2001).

2.1.2. Minimum consideration

None of the three legal systems prescribes a minimum consideration for shares. There is no minimum capital requirement.

2.1.3. Issue of shares

2.1.3.1. Power to issue shares

The RMBCA assigns the power to issue shares to the board of directors, unless the articles of incorporation assign this power to the shareholders (§ 6.21 RMBCA). Also in Delaware (§ 161 DGCL) and Australia (s. 198A CA2001) the board of directors has the power to issue shares. Under Australian law, the board of directors in certain exceptional cases has to obtain the approval of the GMS before new shares can be issued, for instance if there is a situation of variation of class rights (Part. 2F.2 CA2001) or when the issue requires an alteration to the constitution (s. 136 CA2001).

2.1.3.2. Maximum number of shares to be issued

Under Delaware law, the certificate of incorporation must state the maximum number of shares the company may issue per class of shares (§ 102 (a) (4) and § 151 DGCL). When

exercising its power to issue, the board of directors should check per class of shares how many shares have already been issued and how many shares the company has already obliged itself to issue. This number has to be deducted from the number of the class of shares in question stated in the certificate of incorporation, leaving the number of shares that can still be issued. Also according to the RMBCA, the articles of incorporation must indicate the maximum number of shares of each class that the company may issue (§ 2.02 (a) and § 6.01 (a) RMBCA). In Australian law, the requirement that a company must state in its constitution the amount of its authorised share capital in excess of which a resolution to issue shares is void was repealed in 1998. A company is however free to provide in its constitution that directors may not issue shares in excess of a stated limit.

2.1.3.3. Setting the issue price

All three legal systems assign the power to set the share issue price to the board of directors. This is only otherwise if the articles of incorporation (§ 6.21 RMBCA) or the certificate of incorporation (§ 153 (a) and (b) DGCL) state that the shareholders have this power. The directors have a fiduciary duty to set a reasonable issue price. The RMBCA has no specific provisions on this point. The general criterion of § 8.30 RMBCA (business judgment rule) applies. In Delaware's case, for shares with a nominal value the issue price may not be lower than the nominal value (§ 153 (a) DGCL). For the rest, the setting of the issue price is left to the bona fide business judgement of the board of directors. This also applies under Australian law. When exercising their right to set the issue price, "directors must act in good faith in the interests of the company and for proper purposes, with reasonable care and without conflict."

2.1.3.4. Remedies when the issue price is set too low

Under the RMBCA the courts seem to exercise restraint in the event of a dispute over the issue price of shares: only if the price is far removed from the book value of the shares does the business judgment rule offer no further protection. Under the law of Delaware, in certain circumstances directors who issue shares at "no or grossly inadequate consideration" can be held personally responsible for a "waste of corporate assets". Issue of shares at too low a price can also mean that the issue can be annulled. Instead of moving to an annulment of the share issue, in certain circumstances the shareholder concerned can also be required to pay the appropriate price for the shares. In case law it is established that "the stockholder's acceptance

of the stock raises an implied agreement and equitable obligation to pay lawful consideration for it". Under Australian law too, directors can be held responsible by the company or the Australian Securities and Investments Commission (ASIC)²² if they issue shares at too low a price and are thereby guilty of a breach of their fiduciary duties.

2.1.3.5. Deferred payment on shares

The RMBCA contains no provision at all that the sum determined by the directors to be paid for the shares has to be paid immediately. From this we infer that it is possible to agree that part of the full amount payable can be paid at a later date. The DGCL explicitly states that the board of directors can allow deferred payments when issuing shares. Every share certificate issued for shares that are not fully paid up must state the amount paid and the amount that still has to be paid. If no share certificates are issued, this information has to be included in the books and records of the company (§ 156 DGCL). A notable point is that a creditor of the company in certain circumstances can enforce full payment for the shares (§ 162 DGCL). In the case that the company's assets are insufficient to meet the claims of its creditors, the receiver or administrator of the insolvent company, but also a judgement creditor, without reference to the company's board of directors, can request payment of the (remaining) liability of the shareholders concerned (§ 162 (f) DGCL). It is a requirement that a court judgment has been made whereby the company has been ordered to make payment and execution of this order has not led to any result (§ 162 (b) and § 325 DGCL). Moreover, not more than six years should have passed since the day of the share issue or the subscription day (§ 162 (e) DGCL).

Under Australian law the board of directors decides the terms of the issue. This means among other things that the board of directors decides whether part of the issue price for the new shares should be paid at a later date rather than when the shares are issued. In this case the shareholder's liability is limited to the amount unpaid on the shares; s. 516 CA2001. The registration entry at ASIC must show the amount unpaid on each share; s. 601BC (2) (l) (iii) CA2001. Further, in cases of partly paid shares in the company's register of members (s. 169 (3) (f) CA2001) and on any share certificates, the amount unpaid on the shares concerned must

²² ASIC is the government body that registers companies, comparable to the Dutch Chamber of Commerce that manages the Trade Register. ASIC also provides publicly available information on all Australian companies through its database named ASCOT. It is also the principal institution responsible for the regulation of financial products, services and markets.

be stated. Also, the company's constitution often sets out that the company has a lien over partly paid shares for all money called or payable at a fixed time in respect of that share.

2.1.3.6. Pre-emptive rights in share issues

The pre-emptive rights of shareholders is not an aspect of creditor protection. Nevertheless this matter is dealt with here, since pre-emptive rights are inextricably connected with share issues, and because capital protection law contains aspects of shareholder protection as well as aspects of creditor protection.

The RMBCA has no mandatory pre-emptive rights. § 6.30 (a) RMBCA states that existing shareholders only hold pre-emptive rights insofar as the articles of incorporation so determine. If the articles of incorporation contain the statement that "the corporation elects to have pre-emptive rights" or words to that effect, then § 6.30 (b) RMBCA states what principles apply (unless the articles of incorporation state otherwise). The question of pre-emptive rights is therefore left completely to the articles of incorporation.

Also under the law of Delaware, existing shareholders in principle have no legal pre-emptive rights in share issues. Pre-emptive rights can be allocated to shareholders in the certificate of incorporation. It therefore depends on the company's certificate of incorporation whether and to what extent existing shareholders can derive protection from pre-emptive rights in share issues.

In Australian law shareholders in a public company have no legal pre-emptive rights. The situation in a proprietary company is somewhat different. S. 254D CA2001 contains a replaceable rule²³ for proprietary companies for the issue of shares with pre-emptive rights for existing shareholders. If the company has no constitution or has not determined otherwise in its constitution, the shareholders have pre-emptive rights when shares of the same class as they

²³ Since 1998 it has no longer been necessary to draw up a constitution or articles of association when incorporating a company. CA2001 contains a set of rules, known as the replaceable rules, that regulates the internal management of companies and is included in the various sections of CA2001. These rules apply to all companies incorporated after 1 July 1998 and to companies which have withdrawn their constitution. As the name indicates – replaceable rules – the rules operate by default. A company can be incorporated with a certificate of incorporation which deviates in respect of some or all of these rules. The majority of the replaceable rules apply to all types of company. Certain rules however apply only to

hold are issued. The GMS however may authorise the board of directors to make a particular issue of shares without pre-emptive rights being applicable.

2.1.4. Consideration in kind

2.1.4.1. Possible forms of contribution

§ 6.21 (b) RMBCA states that the consideration for shares may consist of “any tangible or intangible property or benefit to the corporation, including cash, promissory notes, services performed, contracts for services to be performed, or other securities of the corporation”. There are thus no limits as to the form of the consideration.

The consideration in accordance with § 153 (a) and (b) DGCL should be paid by the shareholder in the form and manner determined by the board of directors. The consideration may consist of cash, movable or immovable property, any benefit to the company, or a combination thereof (§ 152 DGCL).

Under Australian law the consideration has to represent money’s worth. This follows from the judgment *Re White Star Line Ltd* [1938] 1 All ER 607. A contribution of an undertaking to perform of work or supply services meets this requirement. Only if the consideration is clearly illusory is the payment considered not to have been made.

2.1.4.2. Valuation of the consideration

All three legal systems lack any form of external audit in cases of consideration in kind. In the system of the RMBCA, it is the duty of the directors of the company to determine that the value of the consideration for the shares is adequate. This means that at the time of the consideration they do not have to establish its exact value. Under the law of Delaware the assessment of the board of directors regarding the value to be attributed to the consideration is decisive. This is only otherwise in cases of actual fraud. In Australia too, the valuation of assets contributed for shares is left to the directors. Case law shows “not only that the general adequacy but also the particular value of non-cash consideration for the issue of shares has traditionally been regarded as a question for the directors’ judgment”. Compare the following quotes from court judgments: “The consideration must be based on an honest estimate by the

proprietary companies, see s. 135 CA2001. Other provisions are considered to be replaceable rules for

directors of the value of the assets acquired”; “If the purchase contract itself states a price for the assets acquired, it seems that the price will generally be accepted as the directors’ ‘honest estimate’ of the ‘value’ of those assets”.²⁴

2.1.4.3. Remedies for overvaluation of consideration

In the RMBCA system, the directors must exercise serious business judgment in determining whether the consideration is adequate. If they do not meet this requirement, they can be held liable by the existing shareholders on the grounds of § 8.30 RMBCA. Further, in cases of insolvency the question may arise whether shareholders that have received their shares for assets that were overvalued can be sued on the basis that they have not met their payment obligation. This appears to be very difficult, in view of the judgment of the court of New Jersey in the case *G. Loewus & Company v. Highland Queen Packing Company* 6 A.2d 545 (N.J. Ch. 1939). In this case, 300 shares were issued at a price of \$20. The recipients of the shares met their payment obligation by transferring a business, which later turned out to be worth only \$1500. The court nevertheless ruled that the payment obligation was met, since the contribution of the business – and not the payment of \$20 per share in cash – was the agreed consideration for the shares.

Under the law of Delaware the assessment of the board of directors regarding the value to be attributed to the consideration is decisive, unless there is a situation of actual fraud. From case law, it appears that to prove actual fraud it is required that (i) it can be demonstrated that the consideration was grossly overvalued; (ii) that presumptions and other facts can be shown from which, in combination with the gross overvaluation, actual fraud can be inferred. An important point in this respect is that the Court of Chancery, the court with authority to settle company law disputes, has ruled that an excessive valuation in itself is sufficient for the presumption of actual fraud “if it is sufficiently gross to indicate bad faith or reckless indifference”.

Under Australian law the assessment of the board of directors of the value of the assets to be contributed is in principle decisive; and in such valuation the directors have a large amount of

proprietary companies, but are mandatory for public companies.

²⁴ These quotations come from a report of the Companies and Securities Law Review Committee of September 1986 entitled *Report to the Ministerial Council on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums*, para 7; to be found at <http://www.takeovers.gov.au/display.asp?ContentID=493>.

freedom. If the company receives overvalued assets, the directors may breach their fiduciary duties and be held liable therefore by the company and/or ASIC.

2.1.4.4. Publication contribution data

Contrary to the RMBCA and the DGCL, under which the contribution data do not have to be published, there are publication requirements in Australia in cases of a consideration in kind both at the time of incorporation and thereafter. The application for registration of the company at ASIC must set out the prescribed particulars about the share issue if shares will be issued for a non-cash consideration; s. 117 (2) (1) CA2001. This is not required if the shares will be issued under a written contract and a copy of the contract is lodged with the application for registration. This provision however only applies to a public company. A proprietary company does not have to publish this information.

In cases of share issues after incorporation, s. 254X CA2001 requires a public company to lodge a notice of share issue with ASIC within 28 days after issuing the shares. This notice includes a copy or particulars of any contract whereby shares are issued for non-cash consideration; s. 254X (1) (e) CA2001. This provision also does not apply to a proprietary company.

2.2. Distributions to shareholders

2.2.1. Dividend distribution

2.2.1.1. Authorised entity

In all three legal systems the board of directors is the entity authorised to make distributions. In Australia, the procedure for the distribution of dividend is regulated in the replaceable rules of s. 254U (1) and 254W (2) CA2001. On the basis of the former, the directors are authorised to decide that a dividend is payable and fix the amount, time for payment and method of payment. The methods of payment may include the payment of cash, the issue of shares, the grant of options and the transfer of assets. S. 254W (2) CA2001 states that the directors, subject to the terms on which shares are on issue, may pay dividends as they see fit. On the basis of these replaceable rules the directors have the power to pay a dividend without the need

for a prior dividend declaration by shareholders. The constitution of a company may however contain provisions that deviate from the replaceable rules.

2.2.1.2. Criterion for distribution

§ 6.40 RMBCA sets limits on the making of distributions to shareholders. These limits apply not only to dividend distributions, they also apply to purchase of shares and redemption of redeemable shares. § 1.40 (6) RMBCA contains a definition of the term distribution: “Distribution means a direct or indirect transfer of money or other property (except its own shares) or incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares. A distribution may be in the form of a declaration of payment of a dividend; a purchase, redemption or other acquisition of shares; a distribution of indebtedness or otherwise”. This means that any direct or indirect transfer of assets of the company to shareholders, as well as any obligation the company undertakes in respect of its shareholders, is a distribution to shareholders if the transfer of assets or entering into the obligation is connected with the company’s shares. Since no company assets are involved in the case of distribution of stock dividend, the allocation of stock dividend is not subject to the limits of § 6.40 RMBCA.

According to § 6.40 (c) RMBCA, distributions have to pass a double test. They are not permitted if, after the distribution has been made: “a) the corporation would not be able to pay its debts as they become due in the usual course of business; or b) the corporation’s total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.”

This therefore concerns a combination of a liquidity test (equity insolvency test) and a variant of the balance sheet test (adjusted net worth test). This variant means that a certain capital cushion is maintained. This cushion however concerns only the amount necessary to meet the claims of senior security holders, who have priority with regard to the liquidation balance.

According to the official commentary on § 6.40 RMBCA generally available information will, in most cases in which a business is operating normally as a going concern, make it clear that there are no grounds for an investigation as to whether the company can meet the requirements of the liquidity test. The existence of significant shareholders’ equity and normal operating conditions in themselves form a strong indication that the liquidity test will not cause

problems. When are there then grounds for an investigation into a company's liquidity position? The official commentary to the RMBCA says the following on this point: "It is only when circumstances indicate that the corporation is encountering difficulties or is in an uncertain position concerning its liquidity and operations that the board of directors or, more commonly, the officers or others upon whom they may place reliance under section 8.30 (b), may need to address the issue."

The question then is what form the liquidity test should take. According to the official commentary, due to the "overall judgment required in evaluating the equity insolvency test" one or more bright line tests cannot be relied upon. Several suggestions follow: "In determining whether the equity insolvency test has been met, certain judgments and assumptions as to the future course of the corporation's business are customarily justified, absent clear evidence to the contrary. These include the likelihood that (a) based on existing and contemplated demand for the corporation's products or services, it will be able to generate funds over a period of time sufficient to satisfy its existing and reasonably anticipated obligations as they mature, and (b) indebtedness which matures in the near-term will be refinanced where, on the basis of the corporation's financial condition and future prospects and the general availability of credit to businesses similarly situated, it is reasonable to assume that such refinancing may be accomplished. To the extent that the corporation may be subject to asserted or unasserted contingent liabilities, reasonable judgment as to the likelihood, amount and time of any recovery against the corporation, after giving consideration to the extent to which the corporation is insured or otherwise protected against loss, may be utilized. There may be occasions when it would be useful to consider a cash flow analysis, based on a business forecast and budget, covering a sufficient period of time to permit a conclusion that known obligations of the corporation can reasonably be expected to be satisfied over the period of time that they will mature."

When forming their opinion, according to § 8.30 RMBCA directors may in principle use information, opinions, reports and statements originating from other expert persons. It cannot normally be expected of directors that they should go into the details of the various analyses and market and economic forecasts that can be relevant in depth. § 8.30 RMBCA however states that directors may not adopt an opinion of an expert if they themselves possess information, which makes reliance on that opinion unwarranted.

Finally, the commentary warns against too hasty an assessment of the estimate made by the directors with hindsight. This danger lies mostly in the temptation to make assumptions regarding the company's ability to be able to meet its long-term liabilities, claims that only

mature after several years. The commentary says on this point: “the primary focus of the directors’ decision to make a distribution should normally be on the shorter term, unless special factors concerning the corporation’s prospects require the taking of a longer term perspective.”

The RMBCA is very liberal on the question of the valuation of assets and liabilities associated with the balance sheet test. Directors may use accounting practices and principles that are reasonable in the circumstances or a fair valuation or other method that is reasonable in the circumstances. This means that in principle directors are free to deviate from the GAAP principle that assets must be reported in the balance sheet at historical cost. There is criticism of this to the extent that it can lead to distribution of pure holding gains, which are based on the revaluation of assets. In this respect it should be noted, however, that the RMBCA does not permit selective revaluation.

One important question is what is the relevant date for determining whether a distribution meets the double test of § 6.40 RMBCA. In cases of distribution by purchase, redemption or other acquisition of the company’s shares, the standard date is the date on which money or other property is transferred or a debt is incurred by the company in connection with the distribution. If however the shareholder ceases to be a shareholder with respect to the acquired shares, the date the shareholder ceases to be a shareholder is the standard date. In the case of a distribution of indebtedness, the date the indebtedness is distributed is the standard date. For all other distributions, (including dividend distributions) the answer can be found in § 6.40 (e) (3) RMBCA. The date of the decision by the board of directors applies as the standard date for the the assessment of the lawfulness of the distribution if the payment occurs within 120 days after the date of authorization by the board of directors. If payment occurs more than 120 days after the date of authorization, the standard date is the date the payment is made. The extent of the validity of a positive result from the liquidity and balance sheet tests is therefore not more than 120 days.

Pursuant to § 170 (a) DGCL the board of directors is authorised to make dividend distributions:

- (1) if and to the extent that there is a surplus; or
- (2) if there is no surplus, to the extent that the company has realised a net profit in the financial year in which the dividend is established or the prior financial year.

The company has a surplus if and to the extent that the value of its net assets (assets less liabilities) is greater than the amount of its capital. For the making of dividend distributions

therefore, it is not in itself sufficient that the company's equity is positive (bare net assets test). The company's equity should moreover be greater than the capital of the company (enhanced assets test).

It is also of importance to establish that the board of directors of the company is in principle in a position to determine the amount of the capital. If the company only issues NPV shares, the capital could actually be zero. In this case a dividend distribution is actually subject to the laxer bare net assets test.

If the company has PV shares outstanding, then its capital must equal at least the amount of the total of the nominal values of these shares. By choosing a low nominal value of the shares, the amount of capital can be kept to a minimum and actually also in this case determines whether the company's equity is positive.

It should also be noted that the board of directors can reverse an earlier decision to designate contributions for shares as capital by henceforth considering such contributions as a surplus. In such a case the only conditions to be met are that (i) the capital does not fall below the amount of the nominal value of the outstanding PV shares and (ii) the company has sufficient assets to be able to meet the liabilities for which payment by other means is not foreseen.

The meaning of capital and the protection that creditors can derive there from is therefore extremely relative. In practice, in many cases the only factor determining whether a dividend distribution is justifiable is whether the company's equity is positive and will remain so after a distribution to shareholders has been made.

It is for the board of directors to establish whether the company possesses a sufficient surplus from which to make a dividend distribution. How the board of directors should establish this is not further regulated in the act. In practice, the board of directors usually prepares an interim balance sheet especially for a proposed dividend distribution.

Case law shows that the assessment of whether the company possesses a sufficient surplus is not restricted to actually realised profits. The board of directors should include the fair value of all assets and liabilities in its assessment. One exception to this rule is in § 170 (b) DGCL for the so-called wasting assets corporations, meaning "any corporation engaged in the exploitation of natural resources or other wasting assets, including patents, or engaged primarily in the liquidation of specific assets". These companies can, when determining the available potential for dividend distributions, leave a depletion of wasting assets out of consideration, if this arises from lapse of time, consumption, liquidation or exploitation.

One important exception to the general rule that a company may not make a dividend distribution if it does not have a surplus, is the nimble dividends provision. This provision is

included to allow a company with losses that have not yet been repaired to be able to distribute dividend as soon as it returns to profitability, thus making it easier for such a company to raise fresh equity. The provision means that if a company realises a net profit in the financial year in question or the preceding financial year, this profit may be applied to the making of dividend distributions. In other words, losses sustained in one or more previous financial years do not therefore first have to be repaired.

§ 170 DGCL gives one exception to the authority of the board of directors to distribute nimble dividends: if the company has preference shares outstanding which have a preferential right to the distribution of assets, the realised net profits of the company may not be applied to dividend distributions as long as the value of the net assets of the company is not at least equal to the amount of the capital represented by these preferential shares.

In the literature there is criticism of the nimble dividends provision, as the concept that the capital of the company should act as protection for the company's creditors is further eroded, while the justification for allowing nimble dividends is flimsy. Another criticism is that the provision for nimble dividends in § 170 (a) DGCL raises quite a few questions relating to its unclear formulation.

S. 254T CA2001 states that a dividend may only be paid out of profits of the company. The difficulty however is that the term profits is not defined in the Corporations Act. Moreover, the courts have generally shown a reluctance to define the term precisely. There are many areas of doubt, including the relevance of accounting standards. Case law does not show that the profit as reported in the balance sheet and profit and loss statement necessarily agrees with the statutory term profits.

The standard judgment on this point is *Re Spanish Prospecting Co Ltd* [1911] 1 Ch 92. This contains the following remarks on the meaning of profits: "Profits' implies a comparison between the state of business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison at the two dates ... If the total assets of the business at the two dates be compared, the increase which they show at the later date as compared with the earlier date (due allowance of course being made for any capital introduced into or taken out of the business in the meanwhile) represents in strictness the profits of the business during the period in question." From this it can be inferred that it is sufficient for the calculation of profits to establish that there was a surplus of income over expenses in a particular financial year. No account has to be taken of an expected future reduction in value of certain assets.

Further, it is notable that no distinction is made between increases in the value of fixed and circulating assets in a financial year. From the judgment in *Foster New Trinidad Lake Asphalt Co Ltd* [1901] 1 Ch 208 however, it follows that if a company wishes to pay a dividend from realised increases to its fixed assets it should revalue all its fixed assets.

It is also important that dividends may be paid out of current year revenue profits (meaning the increase in value of the current assets the company holds at the end of the financial year compared with the value of comparable assets at the beginning of that financial year) even if the company had losses in prior years, according to the judgment in *Ammonia Soda Co Ltd v Chamberlain* [1918] 1 Ch 266. A company is therefore not obliged to make good prior year revenue losses. The justification for these nimble dividends is considered as a deficiency in Australian law; such payments should not be permitted if the solvency of the company is doubtful: “There is ... no requirement that a company must make a profit in a given period before being able to authorise and pay a dividend so long as the dividend is paid out of the profits, which may have been achieved in some previous period(s). A company can therefore pay dividends even though it is making losses or has made losses and subsequent profits have yet to extinguish accumulated losses.”²⁵

The meaning of this faulty regulation regarding the payment of dividend to shareholders should however not be overestimated. When entering a share capital transaction, such as a payment of dividend, a company must always take into consideration that this could entail incurring a debt in the meaning of the insolvent trading provisions. If the company is insolvent at the time when it incurs a debt or becomes insolvent by incurring that debt, the directors are subject to liability risks. To avoid this, directors will only pay dividend if the company is solvent. A solvency test is carried out. This is moreover not limited to a cash flow test. Case law (*Quick v Stoland* [1998] 29 ACSR 130, per Emmett J) shows that the company’s entire financial situation is taken into consideration including its activities, assets, liabilities, cash, money to be procured by asset sale or loan and the company’s ability to raise capital. In certain circumstances therefore both a cash flow test and a balance sheet test may be relevant.

2.2.1.3. Remedies

If when making a distribution the directors have acted in conflict with the double test of § 6.40 RMBCA, they can be held liable. § 8.33 (a) RMBCA states that directors who vote for or

²⁵ Australian Accounting Research Foundation (AARF), *Payment of Dividends under the Corporations Act 2001*, april 2002, p. 1; to be found at <http://www.aarf.asn.au/docs/Dividends.pdf>.

assents to distributions in conflict with § 6.40 RMBCA and thereby act in conflict with the duty of care that they must take into consideration on the basis of § 8.30 RMBCA, are personally liable to the company for the excess amount distributed. The directors are protected by the business judgment rule, which among other things states that they may (as long as this is in good faith) base their judgement on information, opinions, reports and statements originating from persons expert in the field. A director successfully held liable cannot only have recourse to liable co-directors, but also to every shareholder who had actual knowledge that the distribution was in conflict with § 6.40 RMBCA. It is also important that the applicable fraudulent transfer rules can be used to compel the shareholder to repay the dividend or the price received for the shares purchased by the company. The fraudulent transfer rules do not correspond to the rules of the RMBCA to the extent that they allow annulment of a transaction with a shareholder who acted in good faith. See par. 2.2.5. for further details of these rules.

Directors that have paid dividend in conflict with § 173 DGCL are in certain circumstances jointly and severally liable to the company and the company's creditors for the full amount of the dividend unlawfully paid, with interest; § 174 DGCL. The conditions are that there is a situation of wilful or negligent violation and that the company is dissolved or turns out to be insolvent within six years after paying such unlawful dividend.

A director who has voted against the board of directors resolution which has been objected to or who was not present at the time it was taken, may be exonerated from liability as long as his dissenting opinion is recorded at the same time in the minutes of the board of directors meeting at which the resolution concerned was taken, or, if the director becomes aware of the resolution at a later date, his dissenting opinion is recorded in the company records without delay.

Any director against whom a claim is successfully asserted under § 174 DGCL, shall be entitled to contribution from the other directors who voted for or concurred in the unlawful dividend (§ 174 (b) DGCL).

Moreover this same director is subrogated to the extent of the amount paid by him according to the provision in § 174 (a) DGCL to the rights of the company against shareholders who received the disputed dividend with knowledge of facts indicating that such dividend was unlawful (§ 174 (c) DGCL).

Furthermore, § 172 DGCL protects directors against personal liability if they have in good faith based the making of distributions on the company's records or upon information,

opinions, reports or statements produced or submitted to the company by one of its officers or employees, committees of the board of directors or any other person.

The shareholders involved can also in certain circumstances be required to repay the amounts they have received incorrectly. § 174 (c) DGCL sets the condition on this point that the shareholder concerned received the dividend with knowledge of facts indicating that such dividend was unlawful. It should also be noted in this connection that the applicable fraudulent transfer rules can be used to compel an unwitting shareholder to repay the dividend. See par. 2.2.5.

Besides the distribution regulations contained in the RMBCA and the DGCL, creditors can derive protection from non-statutory company law (common law). From case law it follows that directors of a company, which is insolvent, or threatens to become so, also have a duty of care to creditors of the company. Violation of this duty of care can lead to liability. The precise extent of this liability is difficult to estimate.

Protection for creditors can also be found in statutory rules outside the area of company law. This concerns the already mentioned rules relating to fraudulent transfers. These rules can lead to avoidance of dividend distributions to shareholders and purchase transactions. Finally, protection can be derived from the doctrine of equitable subordination of claims. See par. 2.2.5. for more details of fraudulent transfer and equitable subordination.

Under Australian law dividends that are paid other than out of profits involve a reduction of capital. If this reduction of capital does not comply with subsection s. 256B (1) CA2001, the company contravenes s. 256D CA2001. This however does not affect the validity of the payment of dividend or any contract or transaction connected with it; s. 256D (2) CA2001. However those involved in a company's contravention of s. 256B CA2001 – who may be directors but also shareholders – may be liable for a so-called civil penalty order under s. 256D (3) in connection with s. 1317E CA2001. This means that ASIC can take this person to court. The remedy can consist of payment of a civil-law fine of up to \$ 200,000, payment of damages to the company or disqualification of the director. A criminal sentence is only possible if the involvement in the contravention of the provision in s. 256D CA2001 was dishonest; s. 256D (4) CA2001.

The directors are also subject to risks of liability on the basis of the insolvent trading provisions. Directors should prevent the company from incurring a debt at a time when the company is insolvent or becomes insolvent by incurring that debt and there are reasonable

grounds for the directors for suspecting that the company is insolvent at the time when the debt is incurred or becomes so by incurring that debt. This is regulated in s. 588G CA2001. In case of paying a dividend, s. 588G (1A) CA2001 states that the company incurs a debt to pay dividend when a dividend is paid or, if the company has a constitution that provides for the declaration of dividends, when the dividend is declared. This means that the directors are subject to liability risks if they pay dividend at a time when they reasonably should have suspected that the company would become insolvent as a result.

If a director has contravened the insolvent trading provisions, there are three different remedies. First, civil law liability. The claim for payment of loss or damages can, in case the company is being wound up, be made by the liquidator or (with the approval of the liquidator or the court dealing with the winding up) a creditor; s. 588M CA2001. Also, ASIC has the power to initiate civil proceedings whether the company is being wound up or not; s. 588J and 588K CA2001. The second remedy concerns a civil penalty. At the request of ASIC the court may make civil penalty orders against directors who contravene the insolvent trading provisions. The court can consist of the imposition of a pecuniary penalty or disqualification of the director(s); s. 1317E, s. 1317G and s. 206C CA2001. For the imposition of a civil penalty, it is a requirement that there is a serious contravention of s. 588G CA2001. Lastly, insolvent trading can be punished with criminal liability. This is only possible if directors had actual suspicion of insolvency and they acted dishonestly when incurring the debt.

2.2.2. Purchase of own shares

2.2.2.1. Authorised entity

In the three legal systems the board of directors is the authorised entity for the purchase of the company's own shares. Under Australian law the approval of the GMS is required in certain cases.

2.2.2.2. Criterion for purchase

Under the RMBCA a purchase of shares is permitted, as long as the limits applying to distributions to shareholders are taken into consideration. Compare the description of § 6.40 RMBCA in par. 2.2.1.2. above. Further, § 6.31 RMBCA states only the following regarding

purchase: “(a) A corporation may acquire its own shares, and shares so acquired constitute authorized but unissued shares; (b) If the articles of incorporation prohibit the reissue of the acquired shares, the number of authorized shares is reduced by the number of shares acquired.”

The RMBCA contains a special rule for cases in which a shareholder sells his shares to the company for a consideration not in cash, but in the form of a long-term note. In these cases the problem may arise that other creditors will feel disadvantaged in the event that the company encounters financial problems, since the shareholder has transformed his position from that of a subordinated to an ordinary creditor. § 6.40 (f) RMBCA states that the claim of the ex-shareholder on the company in connection with the purchase of the shares by the company is ranked equally with claims of other ordinary creditors of the company, unless subordination has been agreed. It is however noted that the answer to the question whether ex-shareholders with claims arising from the sale of shares to the company can enforce their claims in a situation where the company later becomes bankrupt is not solely determined by the state company law based on the RMBCA. The fulfilment of the claim of the ex-shareholder could in certain circumstances be rejected on the basis of fraudulent transfer law. Furthermore, the bankruptcy court in certain circumstances can decide that the claim of the ex-shareholder should be subordinated (equitable subordination). For more details of fraudulent transfer and equitable subordination, see par. 2.2.5.

§ 160 DGCL states that the company may only purchase shares if it can finance the purchase price of these shares out of surplus. If there is no surplus, then the acquisition by the company of its own shares against payment of cash or goods is not permitted. There are two exceptions: (i) the purchase concerns preferential shares; (ii) no preference shares are outstanding and the shares to be purchased are withdrawn by the company at the time of the acquisition and the capital of the company is reduced in accordance with the provisions of § 243 and 244 DGCL; see par. 2.2.3. below.

Based on the provision in s. 259A CA2001 a company is prohibited from purchasing its own shares unless there is a share buy-back to which s. 257A-257J CA2001 apply, an acquisition of fully paid-up shares for no remuneration, an acquisition of shares based on a court order, or an acquisition in circumstances covered by s. 259B (2) or (3) CA2001. This last exception deals with the situation where a company takes security over its own shares under an approved

employee share scheme or the security is taken in the ordinary course of business of a lender and on ordinary commercial terms.

The main exception to the prohibition of the purchase of own shares in practice is the share buy-back. S. 257A CA2001 permits companies to buy back their own shares as long as the following conditions are met. First, the buy-back does “not materially prejudice the company’s ability to pay its creditors”. This means that a liquidity test has to be taken into consideration. In the Australian literature, it is called a solvency test. This test means that before the company buys back its own shares, its directors should determine whether the company is able to pay its debts as and when they fall due. The second condition is that the company follows the procedural requirements as specified in s. 257A-257J CA2001. See below.

The constitution of a company can also prohibit a company from acquiring its own shares or place limitations on the exercise of this right.

Australian company law recognises five different types of share buy-backs, each with its own procedural requirements. There are equal access schemes (s. 257B (2) and (3) CA2001), selective buy-backs (s. 9 CA2001), on-market buy-backs (s. 257B (6) CA2001), employee share scheme buy-backs (s. 9 CA2001) and minimum holding buy-backs (s. 9 CA2001).

S. 257B (1) CA2001 contains a table that indicates the procedural requirements for each type of share buy-back. As a general rule, a company is able to buy back up to 10% of its own shares within a 12-month period (the 10/12 limit) with minimum procedural requirements. The 10/12 limit refers to 10% of the smallest number of votes attaching to voting shares during the last 12 months; s. 257B (4) CA2001. In determining whether this limit has been exceeded, previous buy-backs that occurred in the last 12 months and the voting shares that are subject to the proposed buy-back are taken into account ; s. 257B (5) CA2001. The reference to the smallest number of votes attaching to voting shares on issue is aimed at preventing companies from issuing shares so as to increase the limit permitted for the share buy-back. Only if the 10/12 limit is exceeded must the conditions of the share buy-back be approved by the GMS by means of an ordinary resolution.

The 10/12 limit does not apply to selective buy-backs. This type of buy-back is when an offer to buy back is made to particular shareholders to the exclusion of others, or when the offer is made to holders of shares other than ordinary shares. Since there is a risk that all shareholders are not treated in the same way, the CA2001 imposes more stringent procedural requirements for this type of buy-back. The shareholders must approve the selective buy-back either unanimously, or by special resolution; s. 257D (1) CA2001. Selling shareholders and their associates (s. 10-17 CA2001) cannot vote on this resolution.

Once a company has entered into an agreement to buy back shares, all rights attaching to the shares bought back are suspended. This means that there are no longer any voting or dividend rights attached to the shares and that the company cannot dispose of shares it buys back. Once the transfer of the shares to the company is registered, the shares must be cancelled; s. 257H CA2001. Within one month after the shares are cancelled, the company must lodge a notice with ASIC that sets out the number and class of shares cancelled and the amount paid by the company on the buy-back; s. 254Y CA2001.

2.2.2.3. Remedies

If in the purchase of own shares the directors have acted in conflict within the double test of § 6.40 RMBCA for the making of distributions to shareholders, they can be held liable on the basis of § 8.33 (a) RMBCA. See further in par. 2.2.1.3.

In Delaware the liability of directors for an unlawful purchase of shares is regulated in the same way as for unlawful payment of dividend; § 174 DGCL. See par. 2.2.1.3. The liability of the shareholder from whom the company has unlawfully purchased shares is normally subject to the rules applying to shareholder liability in the event of receipt of improper dividends. See par. 2.2.1.3. This equal status does not however apply in all circumstances, as can be seen from the court judgment on *Kettle Fried Chicken of America, Inc.* 513 F.2d 807 (6th Cir. 1975). In this case, the liquidator of the bankrupt company claimed repayment by the shareholders of the sums they had received from the company in connection with the unlawful purchase of shares. The shareholders argued that they were not aware of the situation that the company's asset position was not sufficient to permit the purchase and that in view of similar dividend cases liability should be rejected. The court rejected this plea from the shareholders by considering that: "The purchase of its own stock by a corporation is not its usual or ordinary course of business and in no sense is comparable to the declaration of a corporate dividend."

The remedies for a breach of the prohibition of acquisition of own shares as specified in s. 259A CA2001 are contained in s. 259F CA2001. There is no question of a criminal offence; s. 259F (1) (b) CA2001. Furthermore, the contravention of the acquisition prohibition does not affect the validity of the acquisition or of any contract or transaction connected with it; s. 259F (1) (a) CA2001. However any person who is involved in the contravention of the acquisition

prohibition by the company – not including shareholders selling in good faith – is acting in conflict with s. 259F CA2001 and can be punished with a civil penalty; s. 259F (2) in connection with s. 1317E CA2001. See par. 2.2.1.3. If a person has acted dishonestly in the contravention of the acquisition prohibition he can be subject to a criminal sentence; s. 259F (3) CA2001.

The foregoing applies similarly to a contravention of the prohibition of taking security over own shares as specified in s. 259B (1) CA2001.

Moreover, on the basis of s. 257J in connection with s. 588G CA2001 the provisions regarding insolvent trading apply. Directors who enter into an agreement on behalf of the company to buy back own shares according to the procedure of s. 257A-257J CA2001 at a time when the company is insolvent or becomes insolvent as a result of the buy-back and there are reasonable grounds for the directors for suspecting that the company is insolvent at the time of the buy-back or becomes so as a result of the buy-back, risk incurring personal liability on the basis of insolvent trading. Also, the liquidator, in a case where a buy-back of own shares has caused the winding up of the company, can request the court to annul the buy-back transaction, so that in certain circumstances the selling shareholders will have to repay the buy-back price they received from the company; s. 588FF CA2001. Such a request will not be granted if the selling shareholders acted in good faith; s. 588FG CA2001.

2.2.3. Capital reduction

2.2.3.1. Authorised entity

Since the RMBCA does not acknowledge legal capital, it has no provisions regarding capital reduction. Under the law of Delaware, the power to reduce capital rests with the board of directors of the company. This is also the case under Australian law, however the approval of the GMS is required.

2.2.3.2. Criterion for capital reduction

§ 244 (b) DGCL states that the condition for a capital reduction is that the company possesses sufficient assets after the transaction to be able to meet its liabilities.

In Australia, s. 256D (1) in connection with s. 256B (1) CA2001 states that a company must not reduce its capital unless it complies with the following requirements: the capital reduction

“(a) is fair and reasonable to the company’s shareholders as a whole; and (b) does not materially prejudice the company’s ability to pay its creditors; and (c) is approved by shareholders under section 256C”.

The requirement that the capital reduction is reasonable and fair to the shareholders “as a whole” means that it is possible that this requirement is met although the capital reduction is not reasonable and fair to each individual shareholder. According to the explanatory memorandum to the 1998 legislation that inserted the current reduction of capital provisions, the following factors are relevant in the assessment of whether a capital reduction is reasonable and fair to the shareholders as a whole: the adequacy of the consideration that is paid to the shareholders; whether the capital reduction would have the practical effect of depriving some shareholders of their rights, for example, by stripping the company of funds that would otherwise be available for distribution to preference shareholders; whether the capital reduction was being used to finance a takeover whereby the takeover provisions are circumvented; “whether the reduction involved an arrangement that should more properly proceed as a scheme of arrangement”.

Further, a liquidity or solvency test applies: before the company reduces its capital, its directors should determine whether the company will, after the reduction has taken place, continue to be able to pay its debts as and when they fall due. It is prescribed that the company lodges the details of a proposed capital reduction with ASIC, so that creditors are aware of the operation. This information may make creditors decide to request an s. 1324-injunction to prevent the capital reduction. At the hearing which follows, it is for the company to show that the capital reduction will have no negative effect on its ability to pay its creditors; s. 1324 (1B) CA2001.

Finally, the capital reduction must be approved by the GMS; s. 256B (1) (c) in connection with s. 256C CA2001. The requirements set for this shareholder approval vary depending on whether the situation is an equal or selective reduction. An equal reduction relates only to ordinary shares, the terms of the reduction are the same for each holder of ordinary shares and applies to each holder of ordinary shares in proportion to the number of ordinary shares held. In all other cases, the reduction is a selective reduction; s. 256B (2) CA2001. An equal reduction of capital must be approved by ordinary resolution; s. 256C (1) CA2001. A selective reduction in principle requires a special resolution. See par. 3.4.1. for the difference between the two types of resolutions. Further it is stipulated that shareholders who are to receive a distribution from the company as part of the capital reduction or are partly or entirely

exempted from their payment requirement may not cast any vote in favour of the capital reduction.

S. 256C (2) last sentence CA2001 gives additional protection to minority shareholders where a selective reduction involves a cancellation of shares. In such cases the capital reduction must also be approved by a special resolution passed at a meeting of the shareholders whose shares are to be cancelled. This recognises the right of shareholders to prevent their shares from being expropriated against their wishes. In the judgment *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* [2001] NSWCA 427, the court held that s. 256C (2) CA2001 requires that the resolution for approval is taken at a separate meeting of this class of shareholders. The class approval for a selective reduction associated with a cancellation of shares can therefore not be taken at the GMS at which the special resolution is passed.

Finally, in cases of capital reduction extra information requirements apply. The normal convening provisions have to be observed, but also the company has to provide the shareholders with a statement setting out all information known to the company that is material to the decision on how to vote on the resolution; s. 256C (4) CA2001. The information important for the shareholders concerns the effects of the capital reduction for certain shareholders and more generally for the shareholders; the interests of the directors in the capital reduction and the correction of any misunderstandings that could arise among shareholders when reading the attached reports or statements.

The company should lodge with ASIC a copy of the notice of the meeting and all attached documents before the notice of the meeting is sent to the shareholders; s. 256C (5) CA2001. A copy of the GMS resolution approving the capital reduction must be lodged with ASIC within 14 days after it is passed and the company must not make the reduction until 14 days after lodgement; s. 256C (3) CA2001. When the capital reduction is associated with a cancellation of shares, a statement to this effect must be filed with ASIC stating the number of shares cancelled, the class of shares and the amount paid by the company; s. 254Y CA2001.

All these information requirements are intended to provide information to creditors and shareholders in advance regarding the proposed capital reduction, so that they can exercise their rights to oppose the capital reduction.

2.2.3.3. Remedies

The DGCL contains no remedy for making distributions as part of a capital reduction in conflict with the statutory regulations. The literature studied makes no mention of any such remedy.

Under Australian law a capital reduction must comply with the requirements set out in s. 256B and s. 256D CA2001. If these requirements are not complied with, the contravention does not affect the validity of the capital reduction or any connected transaction; s. 256D (2) CA2001. However, those involved (s. 79 CA2001) – who may be either directors or shareholders – may be liable under the civil penalty provisions by virtue of s. 256D (3) in connection with s. 1317E CA2001. See par. 2.2.1.3. A criminal sentence is only possible if the involvement in the company's contravention of the provisions in s. 256D CA2001 was dishonest; s. 256D (4) CA2001.

Furthermore, the directors incur liability risks on the basis of the insolvent trading provisions (s. 588G CA2001). In case of a capital reduction, s. 588G (1A) CA2001 states that the company incurs a debt when the reduction takes effect. If the reduction of capital of a company takes effect when the company was insolvent or became insolvent as a result of the capital reduction and there are reasonable grounds for the directors for suspecting that the company is insolvent at the time of the capital reduction or becomes so as a result of capital reduction, the directors risk incurring personal liability on the basis of insolvent trading. See par. 2.2.1.3. for this and other remedies on insolvent trading.

2.2.4. Financial assistance in connection with share transactions

2.2.4.1. Are there special statutory rules?

Contrary to the RMBCA and the DGCL, which set no limitations on the giving of financial assistance by the company for the acquisition of its own shares by a third party, Australian law contains a special statutory regulation for financial assistance. S. 260A (1) CA2001 states that a company may financially assist a person to acquire shares in the company or its holding company only if

- (a) giving the assistance does not materially prejudice:
 - (i) the interests of the company or its shareholders; or
 - (ii) the company's ability to pay its creditors; or
- (b) the assistance is approved by shareholders under section 260B (that section also requires advance notice to ASIC); or

(c) the assistance is exempted under section 260C.

The acquisition of the shares can take place through a share issue, a transfer of shares or in any other way; s. 260A (3) CA2001. The financial assistance may be given before or after the acquisition of the shares and may take the form of paying a dividend; s. 260A (2) CA2001.

It is stipulated that the transaction may not involve any material prejudice. Whether this is the case or not has to be assessed in each case. An example would be the situation that the company withdraws a large sum of money from its bank account and lends it to a company that is bordering on insolvency. If the proposed financial assistance produces material prejudice, this can only be given if the shareholders approve it under s. 260B CA2001 or if the transaction is exempted under s. 260C CA2001. This means that a company can give financial assistance with the approval of its shareholders even in the case that the interests of creditors are harmed; these interests can be at conflict with the interests of the shareholders, and there is no obligation for the company to consult the creditors on the giving of financial assistance. There is however a risk here for the directors. If the company becomes insolvent as a result of giving financial assistance, the directors can be held personally liable on the basis of s. 588G CA2001: insolvent trading.

The requirements for approval by the GMS are given in s. 260B CA2001. The GMS must give its approval by a special resolution or a by resolution agreed to by all ordinary shareholders. The person acquiring the shares or his associates may not cast votes in favour of the resolution; s. 260B (1) CA2001.

S. 260B (4) to (7) CA2001 contain specific publication provisions. If a GMS is convened for the purpose of passing a special resolution to approve the giving of financial assistance, the company must include with the notice of the meeting a statement setting out all information known to the company that is material to the decision on how to vote on the resolution. Previously disclosed information which it would be unreasonable to require to be disclosed again need not be sent to the shareholders. A copy of the notice of the meeting and attached documents must be lodged with ASIC before being sent to the shareholders. The special resolution passed for the purpose of approving the giving of financial assistance must also be lodged with ASIC within 14 days after it is passed; s. 260B (7) CA2001.

S. 260C CA2001 contains certain exceptions to the prohibition of giving financial assistance. Some examples of excepted transactions are:

- certain payment agreements for not fully paid-up shares entered into in the ordinary course of commercial dealing;

- financial assistance given by financial institutions in the ordinary course of business and on ordinary commercial terms ;
- financial assistance given under an employee share scheme approved by the shareholders.

A recent judgment on the giving of financial assistance is *ASIC v Adler* [2002] NSWSC 171. This concerned the giving of financial assistance by a subsidiary company for the acquisition of shares in its holding company by a third party. The New South Wales Supreme Court held that the transaction generated material prejudice for both the holding and the subsidiary due to the lack of safeguards and the disadvantageous terms of the investment. The transaction was therefore deemed to contravene s. 260A CA2001. It was also held that the transaction involved multiple breaches of directors' duties.

2.2.4.2. Remedies

As with a share buy-back, it applies that if the statutory rules are contravened the validity of the financial assistance or any connected transaction is not affected; s. 260D CA2001. However, any person who is involved in a company's contravention of s. 260A CA2001 is subject to the civil penalty provisions by virtue of s. 1317E CA2001. Moreover, the same remedies apply as apply to unjustified payment of dividend. See par. 2.2.1.3.

2.2.5. Other means to protect creditors against harmful distributions

The above has made clear that both the RMBCA and the DGCL contain liberal rules regarding distributions (in the broad sense) to shareholders. It was also however noted that in the US it is not only company law which determines the extent to which restrictions are placed on distributions to shareholders. Two additional techniques outside company law for creditor protection are reversal of a distribution based on fraudulent transfer and subordination of the claim to dividend distribution on the basis of equitable subordination. Rules relating to fraudulent transfers can be found in both the Federal Bankruptcy Code and the law of the states. The latter are mainly based on the Uniform Fraudulent Transfer Act. The authority to subordinate claims is regulated in § 510 of the Federal Bankruptcy Code. This provision does not state under what circumstances a claim should be subordinated. This is left to the courts. Of the above two techniques, the fraudulent transfer rules would seem to be the most important weapon for creditors in practice. In the literature it is often mentioned that

distributions which pass the company law test can still in some cases be overturned by an appeal to the fraudulent transfer rules. One of the requirements for reversal of a distribution on the basis of fraudulent transfer is that the company was in a precarious financial position at the time of the distribution. It is interesting that this is not only seen to be the case when the company at the time of the distribution cannot meet the net assets test or the cash flow test, but also if the company possessed unreasonably small capital at the time of the distribution. A broad interpretation of this criterion can lead to reversal of a distribution that has met either the double test of the RMBCA or the surplus test of the DGCL. Furthermore, the fraudulent transfer rules give creditors the following advantages compared to the company law regulations on distributions. First, it is beyond dispute that the creditor (in bankruptcy: the trustee) can make a claim on the basis of fraudulent transfer; Second, the fraudulent transfer rules can be used to ensure that the (unwitting) shareholder who has received an improper dividend will have to repay it.

In practice, it is not often the case that an appeal on the basis of fraudulent transfer is made regarding a shareholder of a company with a well-diversified share ownership. The principle mainly comes into play in the case of distributions to shareholders of more private companies.

Company creditors in the US can also derive a certain degree of protection from the doctrine of subordination of claims. A successful appeal for subordination can for example mean that a distribution to a large shareholder will be blocked since the claim (e.g. for the payment of dividend) is subordinated in bankruptcy. For this it is necessary to show that the creditor concerned (in this example the large shareholder) has behaved unfairly in his or her management of the corporation'. Case law shows that the following circumstances can play a part in the decision to subordinate: undercapitalisation, exercise of control in conflict with fiduciary standard', the ignoring of the legal independence of the company and the mixing or moving of assets.

This doctrine has a much more limited meaning for the protection of creditors against damaging distributions to shareholders than the fraudulent transfer rules discussed above, for two reasons. First, it can only be invoked against a shareholder who has control of the company. Second, a decision to subordinate apparently requires more than simply a distribution which is disadvantageous to creditors.

In Australia directors incur liability risks when carrying out share capital transactions due to the insolvent trading provision. This has already been addressed in par. 2.2.1.3., 2.2.2.3.,

2.2.3.3. and 2.2.4.2. Furthermore, in case of bankruptcy the liquidator is authorised to annul so-called antecedent transactions. In certain circumstances a share capital transaction could also be reversed with an appeal on the basis of the rules regarding antecedent transactions. Unlike the fraudulent transfer rules in the United States these rules do not provide any significant additional protection for creditors against harmful distributions.

3. Abolition of nominal value of shares

3.1. Introduction

The main purpose of this study is to establish whether other legal systems provide alternative systems for capital protection, and if so, whether (elements of) these systems could be incorporated in Dutch company law, without reducing the level of protection of creditors and shareholders. It turns out that the legal systems studied of RMBCA, Delaware and Australia do indeed offer alternative systems for capital protection. It also emerges that in the legal systems reviewed implementation of these alternative systems usually is associated with abolition of the nominal value of shares. We wish to emphasise here that any implementation of an alternative system for capital protection in Dutch company law does not necessarily have to involve the introduction of shares without nominal value. The issue is however worth consideration, all the more since the study shows that NPV shares and alternative systems for capital protection act as communicating vessels. To be able to assess as well as possible whether NPV shares should be introduced in the Netherlands, we first investigated what functions the nominal value of shares in current Dutch company law fulfils. We then looked at how these functions are fulfilled in the legal systems studied.

First of all, the nominal value of shares is the connection point for the setting of the issue price of shares and the consideration to be paid for the shares. Compare art. 2:80/191 par. 1 BW: When taking a share, the nominal amount must be paid together with the difference between this and the price of the share if higher. The way in which the setting of the issue price of the shares and the asset elements to be contributed is regulated in the legal systems studied has already been discussed in par. 2.1.3. and 2.1.4.

Moreover, the nominal value of shares is important in the setting of the limit for making various distributions to shareholders. Compare art. 2:98/207 par. 2, sub b BW: a company may only acquire fully paid-up own shares for no consideration or if the nominal amount of the shares to be acquired and already held is not more than one tenth (NV) or a half (BV) of the issued capital. Compare also the provision in art. 2:105/216 par. 2 BW: for the making of distributions to shareholders, the company's equity should be greater than the amount of the paid-up and called-up part of the capital plus the statutory reserves and the reserves prescribed

in the articles of association. The meaning of the terms paid-up and called-up capital can only be defined with the help of the term nominal value of shares. The limits set in the legal systems studied on the making of distributions to shareholders have been extensively discussed in par. 2.2.1. to par. 2.2.4.

Moreover, the nominal value in principle determines the voting rights and rights to profits attached to a share. The voting right on shares is regulated in art. 2:118/228 BW; the right to profits in art. 2:105/216 BW. The basic principle is that each shareholder has at least one vote. The distribution of voting rights is proportionate. If the nominal value of the shares is equal, the voting right is measured by the shareholding; if the nominal value of the shares is different, the voting right is measured by the nominal value of the shares. The possibility of deviating from these rules is limited. The basic principle in the appropriation of profits is that this is made in proportion to the nominal amount the shareholder is obliged to pay for the shares. There may be different provisions in the articles of association, as long as a shareholder is not excluded from profit appropriation. It will be discussed below in par. 3.2. how the voting rights and rights to profits are regulated in the legal systems studied.

The nominal value of a share also affects the determination of the thresholds for decision-making at the GMS; for instance the requirements for a majority of votes and a quorum. Compare art. 2:99 par. 6 BW: a majority of at least two thirds of the votes cast is required for a decision for capital reduction, if less than half the issued capital is represented at the meeting. Par. 3.4. sets out the requirements in the legal systems studied which apply to a voting majority and a quorum, with a brief look at decision-making outside a meeting.

Lastly, the nominal value of a share is used as a criterion for determining whether one or more shareholders may make certain claims or certain requests. Compare art. 2:110/220 par. 1 BW: one or more shareholders collectively representing at least one tenth of the issued capital, or such lesser amount as provided for in the articles of association, can at their request be authorised by the court (in summary proceedings) to convene a GMS. The provision in art. 2:346, sub b BW is also relevant: one or more holders of shares or depositary receipts alone or collectively representing at least one tenth of the issued capital or holding rights on a number of shares or depositary receipts to a nominal value of €225,000 or such lower amount provided for in the articles of association, are authorised to submit a request for an

investigation. The criterion used for similar minority rights in the legal systems studied is addressed below in par. 3.3.

This chapter concludes with a discussion of certain aspects of the implementation of shares without nominal value in par. 3.5.

3.2. Voting rights and rights to profits

§ 7.21 (a) RMBCA states that a voting right is attached to each outstanding share unless the articles of incorporation state otherwise. In most cases, the articles of incorporation deviate from the one share, one vote principle. § 6.01 (c) RMBCA gives a wide degree of freedom in the division of voting rights and rights to profits across different classes of shareholders. It is therefore possible to issue shares with multiple, special, conditional or limited voting rights. Nonvoting shares are also permitted. It is also possible to issue shares which have voting rights but no or limited rights to profits. The most important limit on the freedom regarding the allocation of voting rights and rights to profits is that there must always be one or more classes of shares that together have unlimited voting rights and one or more classes of shares that together are entitled to receive the entire liquidity surplus (see § 6.01 (b) RMBCA).

For the rights of holders of shares without voting rights it is important that they may vote as a separate class on amendments to the articles of incorporation, which affect their interests (see § 7.26 and § 10.04 (d) RMBCA).

The law of Delaware is also based on the one share, one vote principle (§ 212 DGCL). There is a wide degree of freedom to deviate from this statutory principle in the certificate of incorporation (§ 151 DGCL). Some of the possibilities are:

- Only limited voting rights are allocated to a particular class of shares. In practice it is not unusual that holders of preference shares only have voting rights on certain far reaching decisions such as the merger and dissolution of the company.
- Only conditional voting rights are allocated to a particular class of shares, meaning that the voting rights depend on certain circumstances.
- No voting rights are allocated to a particular class of shares (nonvoting shares).
- Multiple voting rights are allocated to a particular class of shares.

Also regarding the rights to profits of shareholders the basic principle is that all shares, regardless of their class, share equally in the profits. Here too it is the case that deviation from

this statutory principle in the certificate of incorporation is permitted (§ 151 DGCL). It can for instance be the case that a particular class of shares (preferential shares) has priority over the other shares in the distribution of the profits or a liquidation surplus.

Under Australian law, the main regulation is that in a show of hands each shareholder has one vote, and that in a poll each shareholder has one vote for each share they hold; s. 250E (1) CA2001. This is a replaceable rule; the company can determine otherwise in its constitution. The constitution can allocate either weighted voting rights or diminished voting rights to particular shareholders.

For public companies, s. 254W (1) CA2001 states that the same dividend rights are attached to each share in a class of shares; deviation from this is permitted in the constitution or by means of a special resolution. For proprietary companies s. 254W (2) CA2001 contains a replaceable rule which allows directors to “pay dividends as they see fit”. This is subject to the terms on which shares are on issue.

In many companies, the shares are divided into classes. Class rights are regulated in Part 2F.2 CA2001: s. 246B-246G CA2001. The different classes of shares usually differ from each other in terms of rights to dividend, preference regarding the distribution of dividend, voting rights, preference regarding the repayment of capital in a dissolution and preference regarding the distribution of a liquidation surplus in the event of dissolution.

The fact that a company has issued different classes of shares with different rights must be clearly indicated in its constitution. Further, the application for registration of the company with ASIC must state the class of shares held by the first shareholders; s. 117 (2) (k) (i) CA2001. The company must also lodge a statement with ASIC specifying the division of shares into classes, if the shares previously were not so divided or if the shares have been converted into shares of another class; s. 246F (1) CA2001. Furthermore, a public company must file a copy of every document or resolution with ASIC that attaches, varies or cancels rights to issued or unissued shares; s. 246F (3) CA2001. Finally s. 254A (2) and 254G (2) CA2001 state that a company which issues preference shares or converts ordinary shares into preference shares in its constitution must specify or otherwise approve by means of a special resolution the rights of holders of preference shares with respect to the following: repayment of capital; participation in surplus assets and profits; cumulative and non-cumulative dividend; voting; and priority of payment of capital and dividends in relation to other shares or classes of preference.

The most common class of shares are ordinary shares and preference shares.²⁶ Holders of preference shares often have limited voting rights. For example, they can only exercise their voting rights during a period in which dividend rights are overdue, or only regarding certain decisions such as a capital reduction or the dissolution of the company. Preference shares on the other hand usually give the right to dividend before any distribution is made to the holders of ordinary shares. This in most cases concerns a fixed percentage of the issue price of the shares. Normally, holders of preference shares also have priority for the repayment of the capital they contributed if the company is dissolved. The dividend claims of ordinary shareholders are usually not expressed as a fixed percentage of the issue price of their shares. Ordinary shareholders receive dividend if the company still has surplus profits after the preferential shareholders have been paid.

Another class of shares concerns deferred shares or founder's shares. The holders of these shares only have a right to dividend if a predetermined amount has been paid to the ordinary shareholders. The relationship between deferred shares and ordinary shares is the same as that between preference shares and ordinary shares.

3.3. *Minority rights*

The following describes the minority rights that apply under each legal system for shareholders and the thresholds applying to an appeal based on these rights.

MBCA

Convening a special meeting. The threshold for convening an extraordinary meeting of shareholders based on § 7.02 RMBCA is 10% of all the votes entitled to be cast on an issue proposed to be considered at such a meeting. This threshold may be raised or lowered in the articles of incorporation, if it is not more than 25% of all votes entitled to be cast on any issue to be considered at such a meeting.

Members' right to inspect books. Based on § 16.02 RMBCA, every shareholder may request the company in writing to inspect the records and documents of the company as stated in § 16.01 (e) RMBCA. These include the articles of incorporation, the bylaws, resolutions adopted by the board of directors creating classes of shares, the minutes of shareholder meetings in the

²⁶ Preference shares can then be further sub-divided into participating and non-participating preference

previous three years and all written communications to shareholders over the past three years, including the financial statements furnished on the basis of § 16.20 RMBCA.

Derivative suit. By means of a derivative suit, shareholders achieve that proceedings are initiated on behalf of the company against directors that have failed to observe their fiduciary duties. Each individual shareholder is entitled on the basis of § 7.42 RMBCA to commence a derivative proceeding.

Judicial dissolution. In case of deadlock in the decision-making at board of directors or shareholder level, in case of “illegal, oppressive or fraudulent” behaviour of the directors or those in control of the company, or in case of “misapplication or waste of corporate assets” each shareholder can request the courts to dissolve the company on the basis of § 14.30 RMBCA.

Appraisal Rights. Appraisal rights give dissenting shareholders in certain cases the right to be bought out against payment of the fair value of their shares. Two conditions must be met for an appeal based on appraisal rights: “(1) the action makes a fundamental change in the affected shares; and (2) uncertainty exists concerning the fair value of the affected shares that may cause reasonable persons to differ about the fairness of the corporate action.” In the RMBCA, this is elaborated so that shareholders in non-public companies can appeal on the basis of the appraisal rights in cases of merger, sale of assets or a stock swap (§ 13.02 RMBCA).

Delaware

Members’ right to inspect books. Any shareholder has, upon written demand, the right to inspect the shareholders register and other books and records (§ 220 (b) DGCL). If the company refuses to permit an inspection or does not reply to the demand within five business days, the shareholder may then apply to the Court of Chancery for an order to compel such inspection. The shareholder needs to establish that (i) he is a shareholder, (ii) he has complied with the provision in § 220 DGCL respecting the form and manner of making demand for inspection of the books and records, and (iii) the inspection serves a proper purpose (§ 220 (c) DGCL).

shares or cumulative or non-cumulative preference shares respectively.

Derivative suit. Shareholders have the possibility of making a right of claim in the company's name valid if the board of directors of the company fails to do so. The shareholder submits the right of claim in his own name but on behalf of the company, so that any proceeds thereof goes into the company assets.

Appraisal rights in mergers. Resolutions to approve mergers can be taken by the majority of shareholder votes prescribed by law. Shareholders however have so-called appraisal rights. These allow shareholders who voted against the merger to compel the company to pay the fair value of the shares they hold; § 262 DGCL.

Appointment of receiver. If the company is insolvent, a shareholder can apply to the Court of Chancery to appoint a receiver pursuant to § 291 DGCL.

Australia

Request for a poll. The voting at a GMS is carried out by a show of hands or a poll; compare the replaceable rule in s. 250J CA2001. A poll may be demanded on any resolution; s. 250K CA2001. At least five shareholders entitled to vote on the resolution may demand a poll or shareholders with at least 5% of the votes that may be cast on the resolution on a poll, or the chairman of the GMS; s. 250L CA2001.

Convening a GMS. The request to hold a GMS must be made by the members with at least 5% of the votes that may be cast at the GMS or at least 100 members who are entitled to vote at the GMS²⁷; s. 249D (1) CA2001. The request must be in writing and signed by the members making the request, and it must state any resolution to be proposed at this GMS; s. 249D (2) CA2001. The directors must convene a GMS within 21 days after the request is given to the company; the GMS must be held within two months after the request is given to the company, see s. 249D (5) CA2001. If the directors do not succeed in convening a GMS within the above 21-day period, the members who hold more than 50% of the votes of all of the members who made the request are authorised to convene a GMS; s. 249E (1) CA2001. Such a GMS must be held within three months after the request is given to the company. The costs of holding the GMS are for the account of the company.

²⁷ There is a proposal to abolish the 100-shareholders rule, since this takes no account of the size of the company and therefore grants disproportionate authority to a small group of shareholders. See Proposed Corporations Amendment Bill (No. 2) 2005.

Members with at least 5% of the votes that may be cast at a GMS can also convene a GMS without submitting a prior request to the board of directors; s. 249F CA2001. This option is seldom used, as the costs of this GMS have to be borne by the convening members.

Finally, the court can be requested to convene a GMS “if it is impracticable to call the meeting in any other way”; s. 249G CA2001. This request can be made by a director, but also by any member who would be entitled to vote at the GMS.

Members’ right to inspect books. A member can be authorised by the board of directors to inspect books of the company; a shareholder can also be so authorised by resolution of the GMS. S. 247D CA2001 contains a replaceable rule on this point. Also, a shareholder can be authorised on the basis of a court order to inspect books of the company. The court may only make this order, according to s. 247A (1) CA2001, if it “is satisfied that the applicant is acting in good faith and that the inspection is to be made for a proper purpose.”

Right to submit agenda items. Members with at least 5% of the votes that may be cast on the resolution or at least 100 members who are entitled to vote at a GMS may give a company notice of a resolution that they propose to move at a GMS; s. 249N CA2001.

Unfair or oppressive conduct. Australian company law has various legal means designed to protect the interests of the company and its shareholders if the majority acts unfairly or oppressively. These include the procedure of s. 232 CA2001. The essence of the matter is that it must concern “the conduct of a company’s affairs; or an actual or proposed act or omission by or on behalf of a company; or a resolution, or a proposed resolution, of members or a class of members of a company”. It must be proved that the conduct, the act or the resolution is (i) “contrary to the interests of the members as a whole; or (ii) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.” One member can initiate this procedure; s. 234 CA2001.

Another legal means is derivative action. To better represent the nature of the procedure, this is known as proceedings on behalf of the company. S. 236 (1) (a) CA2001 states that “a member, former member, or person entitled to be registered as a member, of the company or of a related body corporate; or an officer or former officer of the company” may initiate a derivative action.

Moreover, members in certain circumstances can request the court to grant a s. 1324-injunction. Based on the provision in s. 1324 (1) CA2001, the court has a discretionary

authority to grant an order preventing an action being taken in conflict with a provision in CA2001. This does not include actions in conflict with the constitution of the company or a replaceable rule. Only ASIC and those whose interests have been negatively affected can request the court to grant a s. 1324-injunction. If directors of the company act in conflict with their obligations as specified in Ch. 2D CA2001, shareholders acquire this authority. S. 1324 (1A) CA2001 states the cases where it is considered that a contravention of CA2001 affects the interests of creditors or members. In these cases it is for the company to prove that the provisions in CA2001 have not been contravened; s. 1324 (1B) CA2001.

3.4. Voting majority and quorum requirements

3.4.1. Voting majority

Under the RMBCA the default rule regarding the required voting majority for decision-making is that a resolution is taken if the number (of those entitled to vote on the proposed resolution) voting in favour (of a class) exceed the number of those voting against (of this class) (§ 7.25 (c) RMBCA). This principle may be deviated from in the articles of incorporation.

The DGCL makes a distinction regarding what constitutes a required voting majority for shareholder decisions between (i) shareholder decisions that are prescribed by statute and (ii) other shareholder decisions. Concerning shareholder decisions for changing the certificate of incorporation, approval of a merger or conversion, sale of more or less all the assets of the company and dissolution of the company a majority vote of the outstanding shares for which the voting rights can be exercised for the issue in question is required. For the appointment of directors, a majority of votes of the shares represented at the GMS and entitled to vote on the appointment of directors is required. A greater voting majority may be agreed in the certificate of incorporation (§ 102 (b) (4) DGCL).

For other shareholder decisions, a majority vote in favour of the shares represented at the GMS and to which voting rights on the issue in question are attached is required (§ 216 DGCL). Deviations in the certificate of incorporation or the bylaws are however permitted, and the required voting majority can be adjusted either higher or lower.

In Australia a distinction is made between ordinary and special resolutions. For an ordinary resolution a simple majority of votes of those attending the GMS is sufficient ("Ordinary resolutions are passed by a majority of members who are present and voting at the particular

meeting.”). The situation is different for special resolutions. Other matters may be more important, such as amendments to or withdrawal of the constitution; s. 136 (2) CA2001, or a resolution approving a capital reduction, the so-called selective reduction; s. 256C (2) CA2001. Moreover, it may be provided for in a company’s constitution that a certain resolution must be taken using the procedure for special resolutions. It is required that the intention to propose a special resolution and the contents thereof are set out in the notice convening the GMS; s. 249L (c) CA2001. A special resolution must be passed by at least 75% of the votes cast by members entitled to vote on the resolution; s. 9 CA2001.

3.4.2. Quorum

§ 7.25 (a) RMBCA states that a majority of the votes on the shares of one class that is authorised to vote on a particular issue must be represented at the GMS, unless statute or the articles of incorporation provide otherwise. The RMBCA contains no lower or upper threshold that must be observed in a deviation from the default rule of § 7.25 (a) RMBCA in the articles of incorporation. In case of change to a quorum requirement that is stricter than the majority requirement of the default rule, on the basis of § 7.27 (b) RMBCA the same majority as that stated in the change is required.

According to § 216 (1) DGCL, the quorum to take resolutions at the shareholders meeting is in principle set as the majority of the number of outstanding shares for which voting rights can be exercised. For the possibility of deviation from this quorum in the certificate of incorporation or in the bylaws, a distinction has to be made between (i) corporate actions for which a shareholder decision is required by law and (ii) other shareholder decisions. For corporate actions for which a shareholder decision is required by law, such as the approval of a merger or conversion or the dissolution of the company, the quorum may only be amended to the upside. Moreover, this may only occur in the certificate of incorporation (§ 102 (b) (4) DGCL). There is more room to deviate from the quorum of a “majority of the number of outstanding shares for which voting rights can be exercised” stated in § 216 (1) DGCL for other shareholder decisions. A higher or lower quorum may be stipulated in either the certificate of incorporation or the bylaws. The quorum may however not be lower than one third of the shares entitled to vote at a meeting (§ 216 DGCL).

Under Australian law, the quorum required for a GMS in principle consists of two shareholders.²⁸ S. 249T CA2001 contains a replaceable rule on this point. A different quorum requirement may be included in a company's constitution.

3.4.3. Decision-making outside a meeting

The RMBCA allows for the possibility of decision-making outside a meeting. The requirement for a valid decision outside a meeting is that all shareholders holding voting rights on the proposed decision have voted in favour (unanimous consent; § 7.04 (a) RMBCA).

§ 228 DGCL states that shareholders can also take decisions outside a meeting, unless the certificate of incorporation provides otherwise. It is not required that all shareholders consent to the proposed decision. It is sufficient that a consent (or consents) in writing, setting forth the decision to be taken, is signed by the holders of outstanding shares having not less than the minimum number of votes that would be required for taking such a decision at a GMS at which the entire share capital entitled to vote is present and votes.

Under Australian law a proprietary company with more than one member can take a decision without having to convene a GMS if all the members entitled to vote on the resolution sign a document containing a statement that they are in favour of the resolution set out in the document; s. 249A (2) CA2001. This is known as a circulating resolution.

3.5. Aspects of introducing shares without nominal value

3.5.1. Introducing a system of NPV shares

In 1980 and 1917 respectively, the possibility of issuing NPV shares was included in the RMBCA and the DGCL. More recently, in 1998, in Australia the nominal value of shares was abolished. This abolition of the nominal value of shares was compulsory. Companies do not have a choice of issuing shares with or without nominal value. The reasons for this: "... because a system that permitted both par value and no par value shares would unnecessarily complicate the Law and its administration."²⁹

²⁸ A different regulation applies to one-man companies; s. 249B CA2001.

²⁹ See Company Law Review Bill 1997, Explanatory memorandum, nr. 315; to be found at <http://scaleplus.law.gov.au/html/ems/0/1997/0/97246em.htm>.

In Australia the following transition measures were taken in connection with the introduction of shares without nominal value:³⁰

- It had to be clear that the abolition of nominal value related to all shares, both new shares to be issued and those issued before 1 July 1998; s. 1444 Corporations Law: "Section 254C of the new Law applies to shares issued before commencement as well as shares issued after commencement."
- Concerning already issued shares, it had to be made clear what was meant by the amount paid for a share; s. 1445 Corporations Law. It was decided that this did not include the share premium.
- Any amount standing to the credit of the company's share premium account and capital redemption reserve³¹ became part of the company's share capital on 1 July 1998. This share capital account includes all the amounts paid for shares issued by the company collectively ("The share capital account becomes the general pool of funds representing the total consideration paid for all of the shares a company has issued"); s. 1446 Corporations Law.
- Since the term share premium no longer existed, it had to be made clear for what purposes a company could use the amount standing to the credit of its share premium account; s. 1447 Corporations Law.
- It had to be clear that the introduction of shares without nominal value had no effect on the liability of shareholders for calls in respect of money unpaid on shares; s. 1448 Corporations Law.
- It had to be assured that existing agreements in which reference is made to the nominal value of shares would retain their legal force; s. 1449 Corporations Law.

3.5.2. Specific problems with NPV shares

The study did not reveal any specific problems with the introduction of NPV shares in the three legal systems.

3.5.3. Conversion of PV shares in NPV shares and vice versa

³⁰ The transition measures are included in the Corporations Law, date 29-07-2001, Division 10A – Changes resulting from Schedule 5 to the Company Law Review Act 1998; to be found at <http://scaleplus.law.gov.au/html/histact/10/5208/top.htm>.

³¹ A redemption reserve is to be formed in case a company redeems redeemable shares with the help of profits available for distribution; see art. 38 Second EEC-Directive.

Under the law of Delaware, it is possible that a company has shares both with and without nominal value outstanding at the same time. The DGCL contains rules for the conversion of PV shares into NPV shares and vice versa.

Conversion of PV shares into NPV shares. The certificate of incorporation can state that PV shares can be converted into NPV shares at the request of either the shareholder and/or the company (§ 102 (a) (4), § 151 (a) and (e) DGCL). The conversion price and applicable conditions should in this case be stated in the certificate of incorporation. It will therefore depend on the contents of the certificate of incorporation whether, and under what conditions, conversion of PV shares into NPV shares is possible.

PV shares can also be converted into NPV shares by means of an amendment of the certificate of incorporation (§ 242 (a) DGCL). This is also known as a reclassification of outstanding shares. The initiative for such a reclassification lies with the board of directors. The board of directors has to submit its proposal for an amendment of the certificate of incorporation involving a reclassification to the GMS and the holders of shares of the class to be converted (§ 242 (b) DGCL). If both the GMS and the holders of shares of the class to be converted vote in favour of the proposed amendment of the certificate of incorporation with the required majority, the amendment can be implemented (§ 242 (b) (1) and § 103 DGCL).

It is important that a conversion of PV shares into NPV shares does not automatically lead to a capital reduction. A board of director's decision is required for this. The board of directors can only reduce the capital related to the converted shares or the capital that is not related to a certain class of shares "to the extent that such capital exceeds the total aggregate par value or the stated capital of any previously unissued shares issuable upon such conversion or exchange". One other condition is that the company also has enough assets to be able to meet its liabilities after the capital reduction.

Conversion of NPV shares into PV shares. Regarding the conversion of NPV shares into PV shares, please refer to the above remarks on conversion. The DGCL contains no regulation regarding the way in which the nominal value of a share should be calculated in such cases. The conversion of NPV shares into PV shares can lead to a situation in which the capital of the company has to be increased. The capital of the company should indeed at least equal the amount of the aggregate nominal value of the outstanding shares with nominal value.

4. Conclusions and recommendations

4.1. Conclusions

4.1.1. Conclusions regarding consideration for shares

Minimum consideration. The three legal systems do not stipulate any minimum consideration requirement for shares. There is also non-minimum requirement for the amount of the issued and/or paid-up capital. It is left to the founders of the company to determine the amount of the company's equity at the time of incorporation. If it turns out that the company is inadequately financed, repressive measures can be taken. Directors who authorise distributions when the company is in a precarious financial position incur liability risks (par. 2.1.2.).

Power to issue shares. The basic principle in the three legal systems studied is that the board of directors has the power to issue shares. Under the RMBCA, the articles of incorporation of a company may deviate from this general rule.

To properly understand Australian law it is important to realise that the board of directors has very wide-ranging powers on the basis of the provision in s. 198A CA2001. The statutory provision regarding the relationship between the powers of the GMS and those of the board of directors is contrary to Dutch legislation. Art. 2:107/217 BW states that the GMS has all powers within the limits set by statute and the articles of association that are not allocated to the board of directors or others. S. 198A CA2001 on the other hand states: "The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting." The effect of this is that the board of directors has the power to issue shares, unless the law states otherwise. This is only the case in CA2001 in a few situations, for example if there is a variation of class rights or when the issue requires an amendment to the constitution. Under Dutch law, the basis principle is that the GMS has the power to issue shares; the GMS can delegate this power to the board of directors by means of a resolution or in the articles of association (art. 2:96/206 BW) (par. 21.3.1.).

Maximum number of shares that may be issued. There is a difference between the three legal systems regarding the maximum number of shares that may be issued by the board of

directors. In Australian law, the obligation to state the amount of the authorised share capital in the constitution of the company above which issues of shares would be invalid was repealed in 1998. A company may however state in its constitution that the directors may not issue shares above a determined limit. On the other hand, under the law of Delaware the certificate of incorporation must state the maximum number of shares per class of shares that the company may issue (§ 102 (a) (4) and § 151 DGCL). According to the RMBCA too, the articles of incorporation must indicate how many shares of each class the company may issue (§ 2.02 (a) and § 6.01 (a) RMBCA) (par. 2.1.3.2.).

Setting the issue price. In the three legal systems studied, the board of directors not only has the power to issue shares, but also to set the issue price of these shares. Under the RMBCA and in Delaware, the articles of incorporation (certificate of incorporation) may deviate from this general rule. The directors should set a reasonable issue price. If they set the issue price too low, the directors are acting in conflict with their fiduciary duties and thereby incur liability risks (par. 2.1.3.3.).

This regulation is more or less the same in the Netherlands. If under Dutch law the board of directors is authorised to issue shares, it also sets the nominal value of the shares to be issued and any share premium reserve. This is comparable to setting the issue price for the shares.

Deferred payment. The board of directors can allow a deferral of the full payment of the agreed amount when issuing shares in all three legal systems. Under the laws of Delaware and Australia, any share certificates must state the amount not yet paid for the share in question. This information must also be available in the company's records (Delaware: books and records; Australia: company's share register). For Australia, it also applies that the company must state this information in its statement of registration with ASIC. The RMBCA contains no further regulation for shares that are not fully paid up (par. 2.1.3.5.).

Pre-emptive rights in share issues. In Delaware and under the RMBCA, the basic principle is that existing shareholders do not have pre-emptive rights in issues of new shares, although the articles of incorporation (certificate of incorporation) may state otherwise. The situation in Australia is somewhat different. For public companies the situation is as described above. For proprietary companies on the other hand, the general rule is that existing shareholders have pre-emptive rights when shares of the same class as they hold are issued. The constitution may

however state otherwise. The GMS however may authorise the board of directors to make a particular issue of shares without pre-emptive rights being applicable (par. 2.1.3.6.).

Assets to be contributed. The laws of the RMBCA and Delaware in principle place no limitations on the form of considerations in kind. Under the RMBCA, a choice for the contribution of an undertaking to perform work or supply services can have consequences for the transferability of the shares concerned and the dividend received thereon. In Australia, a contribution should represent money's worth. A contribution of an undertaking to perform work or supply services fulfils this requirement (par. 2.1.4.1.).

Valuation of the consideration. The three legal systems studied do not contain a provision that a consideration in kind must be valued by an independent expert. It is the duty of the company's directors to determine that the value of the consideration is adequate. It is notable that in Delaware and under the RMBCA the value attributed by the directors to a non-cash consideration is decisive unless there is a situation of fraud, while in Australia the directors can be guilty of a breach of their fiduciary duties if they overvalue a consideration and can be held liable. At first sight it would appear that directors in Australia are more likely to be liable. Case law on this point however shows that the directors have a large degree of freedom in the valuation of the consideration. Only in cases where a company issues shares to its director against a consideration in kind and this director has overvalued the consideration is there a situation of a breach of his fiduciary duties (duty to avoid conflicts of interests) (par. 2.1.4.2. and 2.1.4.3.).

4.1.2. Conclusions regarding distributions to shareholders

Authorised entity. In all three legal systems studied the board of directors is the entity authorised to make distributions. In Australia, the company's constitution may deviate from this general rule (par. 2.2.1.1.).

Measures for the various distributions. The RMBCA sets a similar limit to the making of various distributions to shareholders, meaning that its regulation is consistent. This is not the case in Delaware and Australia. In Delaware, the basic principle is that the board of directors is only authorised to make dividend distributions if and to the extent that there is a surplus. This also applies to cases where the company purchases its own shares, only two exceptions

are permitted. In Australia on the other hand, the statutory criterion for the making of dividend distributions is that the company should have sufficient profits, while the law prescribes a liquidity or solvency test in cases of share buy-backs, financial assistance and distributions as part of a capital reduction. In practice, due to the additional effect of the insolvent trading provisions, a liquidity or solvency test also applies to the making of dividend distributions (par. 2.2.1.2.; 2.2.2.2.; 2.2.3.2. and 2.2.4.1.).

Criterion for distribution of dividend. The criterion to be considered for making distribution of dividend differs in each legal system under review. Under the RMBCA, there is a double test consisting of a combination of a liquidity test and a variant of the balance sheet test. This variant means that the company should maintain a certain buffer on behalf of the holders of shares with a preferential right with regard to the liquidation surplus. This latter test therefore has little to do with creditor protection.

In Delaware, the basic principle is that the board of directors is only authorised to make dividend distributions if and to the extent that there is a surplus. If a company has issued NPV shares, there is a surplus if the company's equity is positive (bare net assets test). If the company has issued PV shares, then the company's equity should be greater than its capital (enhanced assets test). This also applies if the company has issued NPV shares, and the board of directors has designated part of the consideration for shares as capital. The amount of the capital is the buffer that may not be touched by the making of dividend distributions. There is one exception applying to this basic principle that a company may only make distributions if and to the extent that there is a surplus: the nimble dividends provision. This means that in the absence of a surplus the company nevertheless may distribute dividend to the extent that it has realised net profits in the financial year in which the dividend is set or the previous financial year. This means that losses sustained in a previous financial year do not first have to be made good before the company may distribute dividend. From the point of view of creditor protection, such a regulation is not to be preferred. The financial years should be considered as a whole, so that previously sustained losses have to be made good before dividend distributions can be made. A temporary improvement in a company's financial position should not lead to a distribution being made to the shareholders at a time when this would be at the expense of the company's creditors. Indeed, this would mean that the shareholders would receive a benefit when their position is subordinate to that of the company's creditors.

The statutory criterion in Australia for the payment of dividend is that there must be sufficient profits to do so. The regulation is unclear, since there is no statutory definition of the term

profits and case law does not offer a solution in all cases. A second disadvantage is that a distribution of nimble dividends is permitted. Moreover, in practice, due to the additional effect of the insolvent trading provisions, a liquidity or solvency test applies. It would be better if this test were to be included in the statutory provision on the payment of dividend (par. 2.2.1.2.).

Remedies. In all three legal systems, acting in conflict with the above-mentioned criterion for the distribution of dividend can lead to the liability of the directors towards the company. It is important how this remedy relates to any liability of the shareholders to repay the unlawful dividend distribution received. For example, are the directors only liable for the amount that cannot be reclaimed from the shareholders? It is also relevant whether the shareholders are only obliged to repay the distribution if they have acted in bad faith. Under the RMBCA and in Delaware, a director held liable has recourse to shareholders who acted in bad faith. The fraudulent transfer rules can also be used to compel shareholders who acted in good faith to repay the unlawfully distributed amount they received.

Under Australian law directors and shareholders acting in bad faith – thus not shareholders acting in good faith – may be equally subject to a claim by ASIC to pay damages to the company, among other things. In practice it is more important that the directors incur liability risks under the insolvent trading provisions. This procedure is normally initiated by the liquidator. If a director is guilty of insolvent trading, either the liquidator or ASIC, but also – in certain circumstances – an individual creditor can make a claim for payment of damages. In the first two cases the director has to pay damages to the company in question; in the third case the individual creditor is reimbursed for the damages sustained (par. 2.2.1.3.).

Criterion for purchase. For a purchase of own shares, under the RMBCA the same criterion applies as for making a dividend distribution: a liquidity test and a variant of the balance sheet test. In Delaware too, the same general rule applies: the company may only repurchase its own shares if and to the extent that there is a surplus. Preference shares may however be repurchased at any time. The reason for this is not clear. Another exception concerns a situation in which the company has not issued preference shares and the repurchased shares are withdrawn and the company's capital is reduced simultaneously. The question is, what meaning does this exception have for the surplus rule given the statutory provision that the company should have enough assets available to be able to meet its liabilities after such a capital reduction. In Australia on the other hand, another criterion applies for a dividend

distribution and a share buy-back – at least on paper. The condition for a payment of dividend is that the company should have sufficient profits at its disposal; a liquidity or solvency condition applies for a share buy-back. Due to the additional effect of the insolvent trading provisions however, a liquidity or solvency test also applies when making a dividend distribution (par. 2.2.2.2.).

Other conditions for purchase. In two of the three legal systems the purchase provision is limited to the prescription of a criterion for payment of the acquisition price of the own shares. Only in Australia do further requirements apply. It is notable that here as well – in a somewhat different form – the limit of 10% known in Dutch public company legislation applies. The division of powers between the board of directors and the GMS is also regulated to prevent shareholders being treated inequitably (par. 2.2.2.2.).

Capital reduction. For a capital reduction, in both Delaware – “... no reduction of capital shall be made or effected unless the assets of the corporation remaining after such reduction shall be sufficient to pay any debts of the corporation for which payment has not been otherwise provided.” and Australia – “the reduction: ... does not materially prejudice the company’s ability to pay its creditors” a liquidity test applies. Since the RMBCA does not acknowledge legal capital, it has no provisions regarding capital reduction. The board of directors is authorised to reduce a company’s capital reduction in Delaware; in Australia a capital reduction must be approved by the GMS (par. 2.2.3.1. and 2.2.3.2.).

Financial assistance. Only Australia has a special statutory regulation for financial assistance. Under the RMBCA and in Delaware, the authority of the board of directors includes the assessment of whether the company should enter into such transactions or not. Important elements in Australian regulation are that the approval of the GMS is required and that a liquidity or solvency test must be taken into consideration (par. 2.2.4.1.).

4.1.3. Conclusions regarding abolition of nominal value

Connection of an alternative regime and NPV shares. Introduction of an alternative regime of creditor protection does not necessarily have to involve the introduction of shares without nominal value. On the contrary. The application of for example a liquidity test to the making of distributions to shareholders therefore has nothing to do with whether the nominal value of

shares is abolished or not. Put the other way around, retaining the core elements of the current capital protection regime could go very well with abolition of the nominal value of shares. As in Australia, it could for example be determined that all sums paid for shares are placed in a share capital account. This could – but would not have to – play a part in the capital protection regime, for instance by providing that the share capital account should fulfil the function currently fulfilled by the paid-up and called-up capital plus the reserves required by statute and the articles of association as a buffer in the making of distributions to shareholders (par. 3.1. and 3.5.1.).

Replacement measures. The term nominal value is relative; it has no standard value. The fact that a share has a nominal value is not a fundamental principle of company law. Abolition of the nominal value of shares would have consequences for other areas besides capital protection provisions in (and outside) Book 2 BW. The nominal value is a criterion for determining the voting rights and rights to profits of shareholders. It is also a criterion which can be deviated from in many ways.³² The nominal value of a share also plays a part in determining the thresholds for decision-making in the GMS; the requirements regarding a majority of votes and a quorum. Lastly, the nominal value of a share is used as a criterion for determining whether one or more shareholders can make certain claims or certain requests. If the nominal value is to be abolished, other measures would have to be found. The study shows that in each legal system there are various measures used for each of these issues. We have therefore not chosen a particular criterion to replace the criterion of nominal value. The three legal systems studied have in common that for the determination of the voting rights on shares the criterion is that one share has one vote. There is however much freedom to deviate from this criterion in a company's articles of association. All this means that for instance a notion such as '10% of the issued capital' – depending on the contents of the statutory provision – could be replaced by '10% of the total issued shares' or '10% of the total votes to be cast'. It is also possible to choose an absolute criterion; for example that at the request of at least 100 shareholders a GMS could be convened (par. 3.2.; 3.3.; 3.4.1.; 3.4.2. and 3.4.3.).

4.2. Recommendations

³² See the proposed art. 2:228 BW in the official draft amendment to Book 2 of the Dutch Civil Code (BW) in connection with the rules for private limited liability companies, First Tranche: Organ structure and powers, shares and depositary receipts. See www.flexbv.ez.nl and www.justitie.nl/themas/wetgeving/dossiers/bv-recht/index.asp respectively.

4.2.1. Recommendations regarding consideration for shares

Abolition of provisions regarding the raising of capital. The three legal systems studied offer much more freedom for companies in the area of raising capital than is the case in the Netherlands. It is for the founders and subsequently the directors of the company to assess how the company's operations should be financed and to what degree the amounts paid or assets contributed for the shares should contribute to this. The valuation of the consideration for shares is also left to the founders or directors; they do not have to engage independent experts for this. We concluded before³³ that there are good grounds for abolition of the provisions regarding the raising of capital for BVs. This conclusion also applies to public companies. The provisions go further than necessary for their purpose of giving protection to creditors, and moreover involve unnecessary costs for businesses. This means that the minimum capital requirement, the provisions regarding the payment obligation on shares (statement of the bank that cash consideration is paid and the valuation of a consideration in kind by an independent expert), and the "Nachgründung"-provision (company acquiring assets belonging to founders of the company) would disappear. The legal systems studied do not have such provisions either.

Contribution of future work or services. The researchers also recommend repealing the prohibition on the contribution of an undertaking to perform work or supply services. It is clear that abolition of this prohibition would make Dutch company law more flexible. The study shows that under the RMBCA and in Delaware in principle no limitations apply for the form of a consideration in kind. In Australia a consideration should represent money's worth; a contribution of work or services to be performed meets this requirement.

The basic principle is that a contribution must have a value in economic terms. In this context, it is unclear why a distinction is made between a contribution of a right to one's own or another's work or services and a contribution of goodwill and know how. All these contributions can be valued in economic terms. The former however cannot form a contribution; the latter can. Furthermore, it can be difficult in practice to distinguish between the contribution of know how and the contribution of a right to future work.

³³ See M.L. Lennarts and J.N. Schutte-Veenstra, *Versoepeling van het BV-kapitaalbeschermingsrecht (Relaxation of the capital protection law applicable to private limited companies)*, Final Report dated 31 March 2004, part 47 IVO-series, Deventer: Kluwer, 2004, p. 11-33.

It is obvious that certain risks are involved in a contribution of future work or services, relating to the valuation of such a contribution. Take a situation in which the work or service is not carried out, because the contributor is no longer in a position to do so, having fallen sick or died. If the work or service is of a personal nature and cannot be carried out by another, this means in reality that the agreed contribution for the shares has not and will not be paid. This will necessitate reverting to a cash payment for the shares. The problem usually is that there is no cash available, as people will have chosen to make a contribution in the form of future work or service for a reason. The existence of these risks does not however necessarily mean that such contributions should be prohibited. They should be included in the calculation of the economic value of the work or services to be contributed. The company may require a bank guarantee from the shareholder or that the shareholder takes out insurance to cover these risks with itself as the beneficiary. If this is done, the risks attached to a contribution of future work or services no longer play a part. In all other situations however, this is the case.

4.2.2. Recommendations regarding distributions to shareholders

General aspects of creditor protection. The basic principle should be that creditors have a reasonable prospect that the company will meet its obligations to them in a timely fashion.³⁴ To make a realistic estimate of this, creditors need to have sufficient up-to-date information regarding the financial position of the company concerned. The publication requirements are not adequate in all respects.³⁵ Creditors can inspect the latest adopted annual accounts, but the information these contain is no longer up-to-date even on the date of publication, let alone at such time as it becomes known to a creditor. The financial position of the company could have changed drastically in the mean time. Some progress can be made on this point, partly due to technological developments, which means it must be possible to accelerate the publication of financial information.³⁶ The latest date currently permitted for publication of the annual accounts (13 months after the end of the financial year) should be brought forward to six months, for instance.

³⁴ See J. Rickford, 'Reforming capital: report of the interdisciplinary group on capital maintenance', *European Business Law Review* 2004, Volume 15, issue 4.

³⁵ Reference can also be made to the exemptions on the publication requirements for small and medium-sized BVs; see art. 2:396 and 397 BW.

³⁶ See J.W. Winter, *Afscheid van papier (Farewell to paper)*, Preadvies van de Vereeniging Handelsrecht, (Preliminary report of the Dutch Trade Law Association) 2001, p. 98-102.

More generally, however, the publication of financial information offers only limited protection to creditors. It can discourage them from doing business with the company concerned. The creditors who are already doing business with the company get no protection from the obligation to publish, it does not make that the company pays its debts.³⁷ For this reason, we urge strongly that the publication requirement for companies should not be tightened in the direction of the Australian example.

Creditor protection via a duty to publish is therefore not sufficient. Additional regulations are necessary to prevent the directors of a company taking risks that could temporarily endanger the timely payment of its debts. There are no statutory guarantees against insolvency, but statutory provisions can discourage directors from taking unnecessary risks. We refer here to the legally founded obligation for a proper performance of one's duties in art. 2:9 BW. Compare also the *Staleman-Van de Ven* judgment.³⁸ Directors risk personal liability (to the company) if they fail to observe this obligation. This is an incentive not to take such risks. Compare also the obligation for a proper performance of one's duties based on the provision in art. 2:138/248 BW, as well as the duty of care placed on directors arising from the provision in art. 6:162 BW. If these incentives do not provide enough preventive effect, there is still the repressive effect: if directors are held liable, creditors obtain an additional possibility for collecting their claim or reimbursement for the damage suffered.

Specific creditor protection when making distributions. Specific provisions are necessary if the company makes distributions to shareholders and engages in associated transactions. In comparison to normal commercial transactions, these transactions involve extraordinary risks for creditors. Assets can disappear from the company without anything being received in exchange. Creditors have an interest that a company has sufficient cash available after making distributions to pay the debts as they fall due (in the coming period) in its ordinary course of business.

The current provisions, in particular art. 2:105/216 par. 2 BW, are not adequate. There is very little clarity regarding the answer to the question of how it should be assessed whether a company has sufficient freely distributable assets to make distributions. Further, the linkage to

³⁷ See H. Beckman, 'Minimumkapitaal, aansprakelijkheid en publiciteit: wat moet de crediteur hiermee?' ('Minimum capital, liability and publicity: what should creditors do with this?'), *Ondernemingsrecht* 2004, p. 24.

³⁸ HR 10 January 1997, *NJ* 1997, 360.

the information contained in the annual accounts causes problems.³⁹ The data in the annual accounts are, necessarily, dated as of the moment the decision is made regarding distributions to shareholders. The valuation principles also differ. Under capital protection law only actually realised profits are eligible for establishing the amount available for distribution, while in the International Financial Reporting Standards (IFRS) the realisation principle is increasingly being abandoned in favour of valuation at fair value. Moreover, the IFRS do not take account of capital protection and therefore have no rules regarding the treatment of reserves. Lastly, it is clear from the *Nimox* case⁴⁰ that from the point of view of creditor protection the statutory provision is not sufficient. Also, regardless of what is provided in art. 2:105/216 par. 2 BW regarding the amount available for distribution, the distribution can still be unlawful towards the creditors of the company in cases where serious account has to be taken of the possibility of a shortfall.

Interests to be protected. When implementing a new regime for distributions to shareholders the interests of shareholders and directors have to be taken into account as well as the interests of creditors. If the company makes a profit, the shareholders justifiably wish to share in this as a reward for their investment. Directors have a special responsibility regarding the making of distributions, since financial policy is part of their duties. It is in their interest that the conditions under which distributions can be made are clear. An additional benefit of this is that if these conditions are not observed, there will also be clarity regarding the personal liability of directors.

Director's statement. If we take the special responsibility of directors for the making of distributions to shareholders as the basic principle, it should also be a requirement that they make an explicit statement that the distribution will not negatively affect creditors. This could be in the form of a published statement, in which the directors declare that in their assessment the distribution complies with the applicable requirements. The directors may only implement a resolution by the GMS – or other body indicated in the articles of association – to make a distribution on condition that they submit a positive statement of this type. The board of directors' statement will also clarify the relationship between the GMS and the board of directors (see below). Making a board of directors' statement on the making of distributions

³⁹ See the preliminary report of H. Beckman for the Dutch Trade Law Association in 2003: *Annual Financial Statements and Capital Protection*, p. 3-64.

⁴⁰ See HR 8 November 1991, *NJ* 1992, 174 (*Nimox*).

mandatory will have a negligible effect on administrative costs. We do not suggest that the statement has to be certified by an auditor. A solvency declaration was made mandatory in New Zealand a decade ago, and it works quite satisfactorily.⁴¹ In the UK, the White Paper 'Company Law Reform' of March 2005 proposes a solvency statement to be submitted by the directors if private companies reduce their capital.⁴²

In principle, a GMS resolution for the distribution of dividend constitutes a claim of the shareholders on the company for payment of the dividend amount. This rule should be refined if the above-mentioned board of directors' statement is made mandatory. This will avoid a situation in which the GMS takes a decision to distribute profits and/or reserves and the board of directors does not execute it (i.e. does not make the payment to the shareholders) because the distribution would endanger the company's financial position. This problem does not occur (or hardly ever occurs) in the legal systems studied, since the board of directors has the power to take decisions regarding the payment of dividend. This is different in the Netherlands, where the articles of association of a company usually state that profits are at the disposal of the GMS.⁴³

The problem of a resolution by the GMS that is in principle legal that is not implemented by the directors is not new. The *Nimox* case cited above shows that taking a GMS resolution for dividend distribution, which takes into consideration all the provisions of capital protection, does not indemnify the shareholders and the directors from liability claims of third parties. If the dividend distribution could reasonably have been expected to lead to a situation in which the claims of the company's creditors can no longer be met, both the shareholders and the directors are acting unlawfully in the sense of art. 6:162 BW, if in these circumstances they vote for or implement respectively the resolution to distribute dividend distribution. They have disadvantaged the company's creditors who remain unpaid. They can thus be held liable for reimbursement of the damages suffered by the company's creditors. In the jargon of Book 2 BW, at least in our opinion, this is a decision that is contrary to reasonableness and fairness. The directors would be well advised not to implement such a resolution, since they would incur the above-mentioned liability risks. The above applies also if the directors cannot declare

⁴¹ This appears from a comparative legal report prepared under the responsibility of Rickford. See The Rickford Report, p. 47.

⁴² To be found at <http://www.dti.gov.uk/cld/review.htm>. See the proposed s. 135A and 135B CA1985.

⁴³ The Expert Group proposes bringing the statutory regulation on this point in line with practice. See the final report of the Expert Group, *Vereenvoudiging en Flexibilisering van het Nederlandse BV-recht* ('Simplification and flexibilisation of Dutch private company law') of 6 May 2004, p. 75/76.

that the distribution complies with the applicable requirements due to the company's financial position.

Liquidity test and balance sheet test. The following point is what requirements should be set for the making of distributions to shareholders. The accepted tests in the legal systems studied are the liquidity test and the balance sheet test.

In a liquidity test, the criterion is whether the company, assuming that its operations continue, has sufficient cash available after the making of the distribution to be able to meet the debts which fall due in the coming period (e.g. 12 months) as a result of its ordinary business operations. This type of test is a statutory requirement in Australia for a share buy-back, the giving of financial assistance for the acquisition of own shares by a third party, and a capital reduction. Due to the additional effect of the insolvent trading provisions, the liquidity test also applies to the making of dividend distributions to shareholders. However, the liquidity test is not limited to a cash flow test. Case law shows that the company's entire financial situation is reviewed, including its activities, assets, liabilities, cash, its activities, assets, liabilities, cash, money to be procured by asset sale or loan and the company's ability to raise capital. In certain circumstances therefore both a cash flow test and a balance sheet test may be relevant.

A liquidity test is also prescribed in the RMBCA and in New Zealand⁴⁴, but in combination with a balance sheet test in both cases. The liquidity test provides the creditors with the protection considered necessary. With its focus on the (near) future, it is made clear – at least as far as possible – that it can be reasonably assumed that claims payable by the company in this period can be met. The liquidity test of course contains uncertain elements: while many hard figures are available, certain forecasts have to be taken into consideration. And these are never 100% hard.

In a balance sheet test (or net assets test) the criterion is whether after making a distribution the assets of the company are at least equal to its debts and provisions. Only the surplus may be distributed. A balance sheet test applies in Delaware. It is a basic principle that the board of directors is only authorised to make dividend distributions if and to the extent that there is a surplus. If a company has issued NPV shares, there is a surplus if its equity is positive (bare net assets test). If it has issued PV shares, then its equity needs to be greater than its capital (enhanced assets test). This also applies if the company has issued NPV shares, and the board

⁴⁴ S. 4 NZ Act states: "The company is able to pay its debts as they become due in the normal course of business."

of directors has designated part of the contribution for shares as capital. The amount of the capital – which can be very small – is then the buffer which must not be touched by the making of dividend distributions. In these situations we have an enhanced balance sheet test, since an extra margin has to be considered, the capital. An enhanced balance sheet test also applies under the RMBCA: the company has to maintain a certain buffer on behalf of the holders of shares with a preferential right relating to the liquidation surplus. This buffer however has nothing to do with creditor protection. The enhanced balance sheet test can be set against a simple balance sheet test, such as applies in New Zealand. S. 4 NZ Act states: “The value of the company’s assets is greater than the value of its liabilities, including contingent liabilities.”

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(Groot-Brittannië)

Implementation of a simple balance sheet test. Retaining the enhanced balance sheet test in art. 2:105/216 par. 2 BW means that the current problems will continue. This test does not provide creditors with the desired reasonable prospect that after making a distribution a company will be able to pay its debts as they fall due. And in the interests of the directors, there is not the desired clarity of the conditions under which distributions may take place.

One simplification could consist of replacing the enhanced balance sheet test with a simple balance sheet test. A buffer is built into the current balance sheet test: After a distribution is made, the amount of the company’s assets must be not less than the sum of its debts and provisions plus the amount of the paid-up and called-up capital plus the reserves according to statute and the articles of association. If the nominal value of shares is abolished – see below – one option, if it is decided to retain a buffer, is to replace the present buffer with the amount paid for the shares. Compare the provision in Australia; all payments for shares are included in a so-called share capital account. Since the possible abolition of the minimum capital requirement for BVs is envisaged, the buffer in many cases could end up as a very small amount. However it is questionable what extra protection the prescription of a buffer gives to creditors, and whether such prescription is justified. The prescription of a stiffer balance sheet test appears not to be necessary from the point of view of creditor protection, and this is also a burden for companies. We therefore recommend the introduction of a simple balance sheet test.

The condition of a simple balance sheet test is that a company’s equity may not be negative as a result of a distribution to shareholders. Whether this condition is met should be assessed on the basis of the information in the annual accounts, with all the uncertainties this involves. So

many factors affect the size of a company's equity, such as what is meant by assets and liabilities. The discussion of the position of preference shares under the IFRS is a good example.⁴⁵ Further, the result depends on the accounting principles applied – for example historical cost price or market value – for the valuation of assets and liabilities. Another significant factor is whether the valuation is made on a going concern basis or not. In brief, the result depends on the criteria and accounting principles underlying the calculation, for which rules are set in legislation and financial reporting standards.

We propose that the legislation in force at the time of the decision should be decisive, as should the choices made by companies in this area. The consequence of this is that different standards may apply for both different types of company and the same type of company, depending on the choice made by the company in question. Listed companies have to prepare their consolidated annual accounts in accordance with IFRS from financial year 2005. Unlisted Dutch companies can voluntarily apply IFRS from financial year 2005 for both their unconsolidated and consolidated annual accounts, but also have the option of applying the standards of Title 9 Book 2 BW.

The potential differences in the amount of the distribution arising from the application of different financial reporting standards have been taken into account in our proposal. International developments in the area of financial reporting standards law mean that the link between financial reporting standards law and capital protection law introduced by the Second and Fourth EEC Directives is becoming more tenuous. The actual function of the annual accounts is therefore becoming more defined; the annual accounts are mainly intended to provide information on the company's financial position to its capital providers and other stakeholders.⁴⁶

Combination with liquidity test. The disadvantages of prescribing a simple balance sheet test, such as possible fair value valuations instead of valuations according to the principle of prudence⁴⁷ and the uncertainties involved in the use of several distinct financial reporting standards, are addressed by prescribing a liquidity test alongside the balance sheet test. The simple balance sheet test is a first test to check if the company's assets are greater than its debts and provisions anyway, in other words whether there is room to make a distribution to

⁴⁵ See the articles of Van Dijk and Van Geffen in *Ondernemingsrecht* 2004-6.

⁴⁶ See C.J.A. van Geffen, 'De wijzigingen in het (Europese) jaarrekeningenrecht; invloed op het kapitaalbeschermingsrecht?' ('Changes in (European) annual accounting law; what effect on capital protection law?'), *TvJ* 2003, p. 254 e.v.

⁴⁷ As specified in art. 2:384 para. 2 BW: profits must be realised on balance sheet date.

shareholders. The liquidity test gives additional protection; the distributions will only be made if it is clear that the creditors can be paid thereafter. Application of the liquidity test should therefore prevent distributions to shareholders that have too great an effect on a company's liquidity, so that creditors are disadvantaged. The prescription of a liquidity test is a codification of the *Nimox* case, as it were. The drawback of making only a liquidity test mandatory is that the test has only to consider liabilities in the relatively short term, which is associated with the necessary uncertainties. This is the reason we recommend a simple balance sheet test in combination with a liquidity test. This combination offers creditors a reasonable prospect that after the distribution the company will be able to pay its debts as they fall due.

When prescribing a liquidity test, the interests of the directors also have to be considered. The conditions whereby they can make a distribution to shareholders must be clear. For this reason it must be stated what requirements a liquidity test must meet. It is proposed that the directors prepare a liquidity estimate for the coming 12-month period. The actual requirements this liquidity estimate must meet can be established in consultation with accounting organisations.

Same threshold for the various distributions. From the point of view of consistent legislation, the same threshold should be set for the making of distributions to shareholders regardless of how this is done. This basic principle means that a simple balance sheet test in combination with a liquidity test should apply for the distribution of (interim) dividend, a purchase of own shares and distributions to shareholders as part of a capital reduction. If a separate regulation continues to exist for the giving of financial assistance for the acquisition of the company's own shares – this point is dealt with below – this threshold should also apply for these transactions.

Relaxation of the purchase regulation. The purchase regulation can be limited to prescribing the criterion for payment of the acquisition price for the own shares; the simple balance sheet test in combination with a liquidity test. The 10% threshold does not need to be retained from the point of view of creditor protection. This can be eased – to 50% – or abolished. From the point of view of protecting the interests of shareholders, the division of powers between the board of directors and the GMS must remain the subject of regulation, contrary to the situation under the RMBCA and in Delaware.

Abolition of the right to object to a capital reduction. If a company makes distributions to shareholders as part of a capital reduction, the simple balance sheet test in combination with a liquidity test applies. This provides sufficient protection for creditors. The right to object to a capital reduction – which is unknown in the three legal systems studied – can be abolished.

Abolition of financial assistance provision. The study shows that in two of the three legal systems studied there is no separate regulation regarding the giving of financial assistance to third parties for the acquisition of own shares. Only in Australia is this otherwise. This raises the question of whether a separate statutory regulation as laid down in art. 2:98c/207c BW needs to be retained. Is it not the duty of the board of directors to assess whether such a transaction is in the company's interest or not – risk analysis – and to check whether the company after giving the financial assistance is still in a position to meet the claims of its creditors? If the board of directors does not fulfil this duty adequately, it incurs liability risks. These financial assistance transactions do not differ from other commercial transactions, such as other types of loans to shareholders, directors or third parties, to the extent that a special statutory regulation is justified.

4.2.3. Recommendations regarding abolition of nominal value

Various measures possible. The study shows that the criterion of the nominal value of shares can be quite simply replaced by other measures. No particular criterion is recommended as a replacement. The best possible criterion must be chosen for each regulation. In share issues, the nominal value can be replaced by the issue price; for voting rights the one share one vote idea can be the basic principle. For the determination of rights to profits, the basic principle can be that all shareholders share equally in the profits. Companies must be offered the possibility of deviating from these basic principles in their articles of association. For issues such as voting majority and quorum requirements, a percentage of the total number of votes to be cast can be decisive, or a percentage of the total number of shares. The same applies to the thresholds that must be reached if shareholders wish to make an appeal to certain minority rights. One could also choose an absolute criterion; for example a certain right can be invoked on the request of a certain minimum number of shareholders.

Introduction of NPV shares. The heart of the matter is whether the reasons for abolition of the nominal value of shares are sufficiently convincing. The main argument for abolition, as

appears from the explanations given by the legislators who have introduced shares without nominal value, is that the false appearance generated by the nominal value, whereby it looks as though shares have a certain value but in most cases this does not correspond to reality, is avoided. Legislation should be as simple and clear as possible. Terms that have no distinct meaning should be avoided. Retention of terms simply because of familiarity in practice ignores the fact that future generations of businessmen, investors, lawyers and others will have to become acquainted with them. For this reason we recommend the introduction of NPV shares.

If the nominal value of shares is abolished, it would be best if this was made compulsory. The Dutch legislator can realise this for private companies (BV). The introduction of NPV shares for the public company (NV) is, however, only possible if the Second EEC Directive is amended. It is conceivable that, after such an amendment, the two systems: PV shares and NPV shares, will continue to exist alongside each other. The fact that this is perfectly possible is shown by the company law of Delaware.

Matrix for the Report Alternative Systems for Capital Protection

2.1. CONTRIBUTION	THE NETHERLANDS	RMBCA	DELAWARE	AUSTRALIA
2.1.1. Nominal value shares	Mandatory	Optional, but unimportant	Optional, but significant	Abolished
2.1.2. Minimum consideration				
- Minimum capital	BV: €8,000 NV: €45,000	None	None	None
- Minimum payment requirement	25% nominal amount + share premium at NV taking minimum capital into consideration at BV: €8,000 and at NV: €45,000	None	None	None
- Remedies	Personal liability director; art. 2:69/180 BW	n.a.	n.a.	n.a.
- Enforcement	Company/liquidator	n.a.	n.a.	n.a.
2.1.3. Issue of shares				
2.1.3.1. Power to issue shares	GMS; delegation to board of directors possible	Board of directors ; unless articles of incorporation state otherwise	Board of directors	Board of directors ; in certain exceptional cases approval of GMS required

2.1.3.2. Maximum number of shares to be issued	Statutory requirement statement of amount of authorised capital in the articles of association	Statutory requirement per class of shares	Statutory requirement per class of shares	No statutory requirement; repealed in 1998
2.1.3.3. Setting the issue price	Entity authorised to issue	Board of directors	Board of directors	Board of directors ; a company cannot issue shares gratuitously
2.1.3.4. Remedies for setting too low an issue price	In certain circumstances personal liability director	Liability directors	Liability directors	Liability directors
2.1.3.5. Deferred payment	Possible up to 75% of nominal value; for BV also deferred payment share premium permitted	Possible	Possible; company creditor can compel payment	Possible; statement in company's share register and on any share certificates; registration with ASIC; lien on partly paid shares usually regulated in the constitution
2.1.3.6. Pre-emptive rights in share issues	NVs: shareholders have legal pre-emptive rights in share issues for cash payment in proportion to the collective amount of their shares; exception for preferential shares; BV: pre-emptive rights, unless articles of association state otherwise	No pre-emptive rights, unless allocated in the articles of incorporation	No pre-emptive rights, unless allocated in the certificate of incorporation	Public company: no legal pre-emptive rights; proprietary company: pre-emptive rights, unless constitution states otherwise

2.1.4. Consideration in kind				
2.1.4.1. Elements to be contributed	Unlimited, with exception of right to future work or services	Unlimited, also future work or services	Unlimited, also future work or services	Unlimited, also future work or services
2.1.4.2. Valuation of the consideration	Specification founders /board of directors ; audit by independent expert	Board of directors assesses whether consideration is adequate, good faith, no external audit	Board of directors assesses whether consideration is adequate, good faith, no external audit	Board of directors assesses whether consideration is adequate, honest estimate, no external audit
2.1.4.3. Remedies for overvaluation of a non-cash consideration	In certain circumstances personal liability director	Liability of directors in case of fraud	Liability of directors in case of fraud	Liability of directors in case of breach of fiduciary duty
2.1.4.4. Publication consideration data	Yes, at trade register/Chamber of Commerce	No	No	Yes, at ASIC

2.2. DISTRIBUTIONS TO SHAREHOLDERS	THE NETHERLANDS	RMBCA	DELAWARE	AUSTRALIA
<p>2.2.1. Dividend distribution</p> <p>2.2.1.1. Authorised entity</p> <p>2.2.1.2. Criterion for distribution</p> <p>2.2.1.3. Remedies</p>	<p>GMS</p> <p>Company's equity = paid-up and called-up capital plus reserves according to statute and the articles of association</p> <p>Liability of directors; NV: repayment by shareholders acting in bad faith; BV: repayment by shareholders on grounds of undue payment</p>	<p>Board of directors</p> <p>Solvency and liquidity (\pm 1 year) should be positive; based on fair value (actual value) ? GAAP</p> <p>Liability of directors towards the company, if distribution is in conflict with § 6.40 RMBCA and the director has acted in conflict with the business judgment rule; repayment by shareholders with actual knowledge</p>	<p>Board of directors</p> <p>Solvency should be greater than capital; exception: nimble dividends; based on fair value (actual value)</p> <p>Liability of directors towards the company, if distribution is in conflict with § 173 DGCL and the case involves wilful or negligent breach and the company becomes insolvent or is dissolved within six years; repayment by shareholders with actual knowledge</p>	<p>Board of directors, unless constitution states otherwise</p> <p>Law: as long as there are profits; meaning unclear; exception: nimble dividends; Additional liquidity test due to insolvent trading provisions</p> <p>Involved director: payment of civil-law penalty (a), payment of damage to company (b), disqualification (c), possible criminal sentence in case of dishonesty (d) plus liability in case of insolvent trading (e); Involved shareholder: ditto (a), (b) and (d)</p>

<p>2.2.2. Purchase of own_shares</p> <p>2.2.2.1. Authorised entity</p> <p>2.2.2.2. Criterion for purchase</p>	<p>Board of directors; authorisation of GMS required</p> <p>For acquisition of shares other than for no consideration: - Company's equity less acquisition price = paid-up and called-up capital plus reserves according to statute and the articles of association</p>	<p>Board of directors</p> <p>Same as for dividend distribution</p>	<p>Board of directors</p> <p>Solvency should be greater than capital; exception: preference shares can simply be repurchased; based on fair value</p>	<p>Board of directors ; in certain cases approval of GMS required</p> <p>Five types of share buy- backs each with own procedural requirements; sometimes 10/12 limit applies ; sometimes approval of GMS required; purchase can be prohibited or limited in</p>
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2.2.2.3 Remedies	<ul style="list-style-type: none"> - BV: max. 50% own shares; NV: max. 10% own shares - Articles of association must permit purchase - authorisation of GMS <p>Purchase of registered shares invalid; Liability of directors towards seller acting in good faith; Bearer shares transferred to directors at time of acquisition; Liability of directors towards company</p>	Same as for dividend distribution	In principle same as for dividend distribution	<p>constitution; liquidity test applies to all types</p> <p>Same as for dividend distribution</p>
2.2.3. Capital reduction				
2.2.3.1. Authorised entity	GMS	n.a.; the RMBCA has no legal capital	Board of directors	Board of directors , however approval of GMS required
2.2.3.2. Criterion for capital reduction	For repayment for shares company's equity less repayment = paid-up and called-up capital plus reserves according to statute and the articles of association	n.a.	Company have sufficient assets after the capital reduction to be able to meet its debts	Liquidity test: the company must be able to pay its creditors after the capital reduction
2.2.3.3. Remedies	A decision for repayment when company's equity is lower than the above threshold is invalid;	n.a.	Unknown	Same as for dividend distribution

	discussion point. Repayment by shareholders on grounds of undue payment			
2.2.4. Financial assistance in connection with share transactions				
2.2.4.1. Are there special statutory rules?	Yes, prohibition on providing security, giving of a price guarantee; for NVs prohibition on granting loans with a view to the acquisition of its own shares; BVs may grant such loans only up to the amount of the distributable reserves	No	No	Yes, financial assistance is permitted, subject to approval of the GMS and taking liquidity test into consideration (“the financial assistance does not materially prejudice the company’s ability to pay its creditors”)
2.2.4.2. Remedies	Yes, prevailing doctrine: invalidity	Not in company law; outside fraudulent trading	Not in company law; outside fraudulent trading	Same as for dividend distribution
2.2.5. Other means for creditor protection against damages by distributions	Bankruptcy pauliana; unlawful act	Fraudulent transfer; equitable subordination	Fraudulent transfer; equitable subordination	Insolvent trading; antecedent transactions: uncommercial transactions; unfair

				preferences; unfair loans
3. ABOLITION NOMINAL VALUE	THE NETHERLANDS	RMBCA	DELAWARE	AUSTRALIA
3.2. Voting rights and rights to profits	Voting rights divided proportionally, measured by shareholding if nominal value of the shares is equal and by nominal value if not. Limited possibility of deviation. Shares without voting rights not possible. The profit appropriation is made in proportion to the paid-up nominal amount of the share; deviation is	One share, one vote principle, deviation is possible in the articles of incorporation; wide freedom in the division of voting and profit rights across different classes of shares; both shares without voting rights and shares without profit rights possible	One share, one vote principle, deviation is possible in the certificate of incorporation; wide freedom in the division of voting and profit rights across different classes of shares; nonvoting-shares possible	One share, one vote principle, deviation is possible in the constitution; wide freedom in the division of voting and profit rights across different classes of shares; weighted and diminished voting rights possible

	possible in the articles of association; shares without rights to profits not possible			
3.3. Minority rights	<p>Thresholds:</p> <ul style="list-style-type: none"> - convening of GMS via legal authority: 10% of the issued capital; - disputes regulation: one third of the issued capital; - right of inquiry: 10% of the issued capital of shares with a nominal value of at least €25,000 	<p>Thresholds:</p> <ul style="list-style-type: none"> - convening of GMS: 10% of the votes; - inspection of books: any shareholder; - derivative suit: any shareholder - judicial dissolution: any shareholder 	<p>Thresholds:</p> <ul style="list-style-type: none"> - inspection of books: any shareholder; - derivative suit: any shareholder; - appointment of receiver: any shareholder; 	<p>Thresholds:</p> <ul style="list-style-type: none"> - requests for a vote: 5 shareholders with voting rights or at least 5% of the votes; - convening of GMS: 5% of the votes or 100 shareholders; - inspection of books: any shareholder; - right to put items on agenda: 5% of the votes or 100 shareholders; - derivative action: any shareholder;
3.4. Voting majority and quorum requirements				
3.4.1. Voting majority	Simple majority of votes, unless the law or the articles of association prescribe a larger majority for certain decisions	Simple majority of votes, unless the articles of incorporation state otherwise	Regarding legally prescribed GMS decisions: majority of the outstanding shares with voting rights on the issue in question; other GMS decisions: majority of the shares with voting rights represented at the GMS	Ordinary resolution: simple majority of votes of shareholders present at GMS; the law or the constitution can prescribe that a special resolution is required: 75% majority of the votes of shareholders authorised

3.4.2. Quorum	In some cases the law prescribes a quorum requirement, e.g. that the entire capital is represented or that the votes cast represent more than half the issued capital; the articles of association may prescribe quorum requirements for other resolutions	A majority of the votes on the shares of a class entitled to vote on a particular issue must be represented, unless the law or the articles of incorporation state otherwise	A majority of the number of outstanding shares for which voting rights can be exercised, unless the certificate of incorporation states otherwise	to vote Two shareholders, unless the constitution states otherwise
3.4.3. Decision-making outside meeting	Unanimity required with written casting of votes; art. 2:128/238 BW	Unanimity required of all shareholders with voting rights on the issue	The written approval of shareholders who collectively have the number of votes that would be required for taking the decision at a GMS is sufficient	Proprietary company: circulating resolution required: all shareholders entitled to vote sign a document stating their support for the decision in question