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 of 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.