

**DEPARTMENT FOR BUSINESS
ENTERPRISE & REGULATORY REFORM**

**EUROPEAN COMPANY LAW AND
CORPORATE GOVERNANCE**

**Companies (Reduction of Capital
Regulations) 2008**

Draft Regulations

OCTOBER 2007

Companies (Reduction of Capital Regulations) 2008

DRAFT REGULATIONS

October 2007

The Companies (Reduction of Capital Regulations) 2008 implement the Creditor Protection Provisions of Directive 2006/68/EC amending the Second Company Law Directive covering Capital Maintenance.

The consultation on implementation of Directive 2006/68/EC closed on 30th June. The draft regulations are now being published for information as part of the government response to the consultation. However, we welcome any comments on the draft regulations, by **9th November 2007**. Comments should be sent, preferably by email, to:

Julie Ford
Corporate Law and Governance Directorate
Department of Trade and Industry
1 Victoria Street
London
SW1H 0ET

Email: Julie.ford@berr.gsi.gov.uk

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Additional copies of this document may be made without seeking permission or be downloaded from the Department's website on:

<http://www.berr.gov.uk/bbf/eu-company-law/directives/page19528.html>

Confidentiality: Your comments may be made public by BERR. If you do not want your name or all or part of your response made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only to information in your response for which confidentiality has been requested.

We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1998.

Companies (Reduction of Capital Regulations) 2008

DRAFT REGULATIONS

October 2007

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Companies (Reduction of Capital Regulations) 2008

DRAFT REGULATIONS

Background

1. In February 2007 the Government consulted on the implementation of the Simplification of Capital Maintenance Directive (2006/68/EC)¹ which amends the Second Company Law Directive on Capital Maintenance (77/91/EEC)².
2. The aim of the new Directive is to simplify provisions in the Second Directive to improve the efficiency and competitiveness of companies by making it easier for them to react more efficiently to market developments.
3. The consultation on the new Directive formed Chapter 6 of the consultation on the implementation of the Companies Act 2006, which can be found at: <http://www.berr.gov.uk/consultations/page37980.html>.
4. The Government Response to those aspects of the consultation was published in June 2007 and can be found at: <http://www.berr.gov.uk/bbf/eu-company-law/directives/page40569.html>.
5. In the Government Response, BERR indicated that it would amend the Companies Act 1985 (and 2006) to reflect the creditor protection elements of the new Directive, in particular the shift of the burden of proof from the company to the creditor when objecting to a reduction of capital. This notice accompanies a draft of the Regulations which implement this change. These Regulations will be made at the end of the year and will come into force on 6 April 2008.

1 A copy of Directive 2006/68/EC is available from the following link:

http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_264/l_26420060925en00320036.pdf

2 A copy of Directive 77/91/EEC is available from the following link:

http://europa.eu.int/eur-lex/en/consleg/pdf/1977/en_1977L0091_do_001.pdf

The Companies (Reduction of Capital) Regulations 2008

6. The draft regulations are intended to implement the requirements introduced by the Simplification of Capital Maintenance Directive that creditors are only entitled to object to a proposed reduction in capital maintenance if they can 'credibly demonstrate that due to the reduction in the subscribed capital the satisfaction of their claims is at stake, and that no adequate safeguards have been obtained from the company'.

7. The draft Regulations achieve this by adding a requirement that creditors must 'show that there is a real likelihood that the proposed reduction will put at risk the due discharge of the debt or claim' to the reduction of capital provisions in the Companies Acts (section 136(3) of the 1985 Act and section 646(1) of the 2006 Act).

8. The draft Regulations therefore replace the provisions in section 136(2) of the 1985 Act, and 645(2)-(4) of the 2006 Act that set out the circumstances when creditors are entitled to object to a reduction in capital.

Other amendments to the Companies Acts 1985 and 2006

9. This shift of emphasis to creditors permits additional simplification of the existing legislation. The draft Regulations remove the provisions in the existing Companies Acts that require the Courts to ascertain the names of the creditors who wish to object to the reduction. This requirement can no longer be necessary, since under the amended legislation, creditors must make themselves known to the Court to object. (So the draft Regulations remove section 136(4) (a) of the 1985 Act, and 646(3) (a) of the 2006 Act.)

10. Sections 137(2)-(3) of the 1985 Act and sections 648(3)-(4) of the 2006 Act are options which allow the Courts to make information about capital reduction known to the public. The purpose of the wider provisions is to protect creditors, and clearly these specific provisions do not help to achieve this aim any more. As they are not necessary, the draft Regulations removes them.

11. Section 141 of the 1985 Act and section 647 of the 2006 Act create an offence where companies conceal their creditors. However, since the onus is now on creditors to object, and not on the companies to provide details of creditors, these provisions are redundant and are removed by the draft Regulations.

12. If you have any comment on the draft regulations implement creditor protection safeguards as set out in. Comments should be submitted **by 9th November 2007**, preferably by email, to:

Julie Ford
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1 Victoria Street
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2008 No.

COMPANIES

The Companies (Reduction of Capital) Regulations 2008

Made - - - - - ***

Laid before Parliament ***

Coming into force - - - - - 6th April 2008

The Secretary of State makes the following regulations under section 2(2) of the European Communities Act 1972(3) and section 657 of the Companies Act 2006(4).

In accordance with paragraph 2(2) of Schedule 2 to the European Communities Act 1972 and section 1290 of the Companies Act 2006 a draft of this instrument was laid before Parliament and approved by a resolution of each House of Parliament.

Citation, commencement and transitional provision

1. —(1) These Regulations may be cited as the Companies (Reduction of Capital) Regulations 2008.
- (2) These Regulations come into force on 6th April 2008
- (3) These Regulations do not apply in relation to an application under section 136 of the Companies Act 1985(5) made before that date.

Amendments of the Companies Act 1985

2. —(1) Section 136 of the Companies Act 1985 (reduction of capital: application to court for order of confirmation), is amended as follows.

- (2) Omit subsection (2).
- (3) For subsections (3) and (4) substitute—

“(3) Every creditor of the company who—

 - (a) is entitled, at the date fixed by the court, to a debt or claim that, if that date were the commencement of the winding up of the company, would be admissible in proof against the company, and
 - (b) shows that there is a real likelihood that the proposed reduction will put at risk the due discharge of the debt or claim,

is entitled to object to the reduction.

(4) The court shall settle a list of creditors entitled to object, and for that purpose may publish notices fixing a day or days within which creditors are to claim to be entered on the list or are to be excluded from the right of objecting to the reduction of capital.”.

3. In section 137 of that Act (court order confirming reduction), omit subsections (2) and (3).

(3) 1972 c. 68.
(4) 2006 c. 46.
(5) 1985 c. 6.

4. Omit section 141 of that Act (penalty for concealing name of creditor etc).

Amendments of the Companies Act 2006

5.—(1) In section 645 of the Companies Act 2006 (reduction of capital: application to court for order of confirmation), omit subsections (2) to (4).

6.—(1) Section 646 of that Act (creditors entitled to object to reduction) is amended as follows.

(2) For subsection (1) substitute—

“(1) Every creditor of the company who—

(a) is entitled, at the date fixed by the court, to a debt or claim that, if that date were the commencement of the winding up of the company, would be admissible in proof against the company, and

(b) shows that there is a real likelihood that the proposed reduction will put at risk the due discharge of the debt or claim,

is entitled to object to the reduction.”.

(3) For subsection (3) (procedure for settling list of creditors entitled to object) substitute—

“(3) The court may publish notices fixing a day or days within which creditors are to claim to be entered on the list or are to be excluded from the right of objecting to the reduction of capital.”.

7. Omit section 647 of that Act (offences in connection with list of creditors).

8. In section 648 of that Act (court order confirming reduction), omit subsections (3) and (4).

Name
Parliamentary Under Secretary of State
Department of Business, Enterprise and Regulatory Reform

Summary: Intervention & Options

| | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|-------------------------------|
| Department /Agency: Business, Enterprise and Regulatory Reform | Title: Impact Assessment of The Companies (Reduction of Capital) Regulations 2008 | |
| Stage: Implementation | Version: One | Date: 1 September 2007 |
| Related Publications: The Government response to the consultation on the implementation of amendments to the 2nd Company Law Directive | | |

Available to view or download at:

<http://www.berr.gov.uk/bbf/eu-company-law/directives/page40569.html>

Contact for enquiries: Julie Ford

Telephone: 020 7215 2162

What is the problem under consideration? Why is government intervention necessary?

To give effect in UK law to a requirement in Directive 2006/68/EC amending the covering maintenance of a companies' capital, which shifts the burden of proof from the company to the creditor when objecting to a reduction of a companies capital.

What are the policy objectives and the intended effects?

To improve the efficiency and competitiveness of companies by making it easier for them to react more promptly and at less cost to developments in the markets without reducing the protection offered to shareholders and creditors.

What policy options have been considered? Please justify any preferred option.

1. Do Nothing.
2. Implement the requirement shifting the burden of proof in respect of Creditor Protection.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? To be confirmed. EU Simplification plans and a review of the capital maintenance regime currently underway at EU level by KPMG (Germany) will probably lead to early review of this policy.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Stephen Timms

Date:

2 October 2007

Summary: Analysis & Evidence

| | |
|-------------------------|---------------------------------------------------------------------------------------------------------------|
| Policy Option: 2 | Description: Implement the requirement shifting the burden of proof in respect of Creditor Protection. |
|-------------------------|---------------------------------------------------------------------------------------------------------------|

| | | | | | |
|--------------------------------------------------------------------|------------------------------------------------|------------|-------------------------------------------------------------------------------|----------|--|
| COSTS | ANNUAL COSTS | | Description and scale of key monetised costs by 'main affected groups' | | |
| | One-off (Transition) | Yrs | | | |
| | £ 0 | 0 | | | |
| | Average Annual Cost (excluding one-off) | | | | |
| | £ 0 | | | | |
| | | | Total Cost (PV) | £ | |
| Other key non-monetised costs by 'main affected groups' N/A | | | | | |

| | | | | | |
|-------------------------------------------------------------------|---------------------------------------------------|------------|----------------------------------------------------------------------------------|---------------------|--|
| BENEFITS | ANNUAL BENEFITS | | Description and scale of key monetised benefits by 'main affected groups' | | |
| | One-off | Yrs | | | |
| | £ 0 | 0 | | | |
| | Average Annual Benefit (excluding one-off) | | | | |
| | £ 544,616.10 | | | | |
| | | | Total Benefit (PV) | £ 544,616.10 | |
| Other key non-monetised benefits by 'main affected groups' | | | | | |

Key Assumptions/Sensitivities/Risks

That this shift in the burden of proof will shift costs to creditors from companies, and will not result in additional costs or savings. The regulations will apply to public limited companies in the UK all private companies are exempt.

| | | | |
|----------------------|----------------------|---------------------------------------|-----------------------------------------------|
| Price Base Year 0 | Time Period Years | Net Benefit Range (NPV) £ 0 | NET BENEFIT (NPV Best estimate) £ 0 |
|----------------------|----------------------|---------------------------------------|-----------------------------------------------|

| | | | | | |
|----------------------------------------------------------------|--|--------|--------|--------|--------------|
| What is the geographic coverage of the policy/option? | | | | | |
| On what date will the policy be implemented? | | | | | 6 April 2008 |
| Which organisation(s) will enforce the policy? | | | | | |
| What is the total annual cost of enforcement for these | | | | | £ |
| Does enforcement comply with Hampton principles? | | | | | Yes |
| Will implementation go beyond minimum EU requirements? | | | | | No |
| What is the value of the proposed offsetting measure per year? | | | | | £ 0 |
| What is the value of changes in greenhouse gas emissions? | | | | | £ 0 |
| Will the proposal have a significant impact on competition? | | | | | Yes/No |
| Annual cost (£-£) per organisation (excluding one-off) | | Micro | Small | Medium | Large |
| Are any of these organisations exempt? | | Yes/No | Yes/No | N/A | N/A |

| | | | | |
|-------------------------------------------------------|-----|----------|--------------|----------------------------|
| Impact on Admin Burdens Baseline (2005 Prices) | | | | (Increase - Decrease) |
| Increase | £ 0 | Decrease | £ 544,616.10 | Net £ 544,616.10 |

Evidence Base

The Companies (Reduction of Capital) Regulations 2008

PROPOSAL

1. On 29 October 2004 the European Commission published its proposal for a directive of the European Parliament and of the Council to amend Council directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (The Second Company Law Directive). The amending Directive (2006/68/EC) was published on 25 September 2006. Member states are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 15 April 2008.

The full text of the Directive can be found at:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:264:0032:01:EN:HTML>

The Companies (Reduction of Capital) Regulations 2008 implement the requirement in the Directive in respect of creditor protection.

OBJECTIVE

2. The Companies (Reduction of Capital) Regulations 2008 implement an amendment to UK law required by Directive 2006/68/EC which shifts the burden of proof in the case of a reduction in a companies capital from the company to the creditor. The Directive sought to simplify capital maintenance provisions across the EU, and to improve the efficiency and competitiveness of companies by making it easier for them to react more promptly and at less cost to developments in the markets without reducing the protection offered to shareholders and creditors.

BACKGROUND

3. Under UK law, subject to confirmation by the court, a public company may reduce its share capital. The 1985 Act also requires the company to be authorised by its articles of association before it can reduce its capital: but this

is not a requirement of the 2006 Act. Under section 646 of the 2006 Act, any creditor of the company is entitled to object to a reduction.

4. Directive 2006/68/EC requires creditors be given the right to seek relief in respect of a capital reduction scheme “where they can credibly demonstrate that due to the reduction in subscribed capital the satisfaction of their claim is at stake”. If the right of creditors to object to a reduction of capital is limited in line with the Directive, companies engaged in capital reduction schemes would benefit as fewer creditors would be able to apply to the courts to object.
5. Even without such express provision in UK law, it is difficult to conceive of circumstances in which a significant creditor could not object if it could credibly demonstrate to the court that its claim was at stake due to a reduction in capital. The notion of capital maintenance holds that capital is a reserve that underpins the security of the claims of creditors. If the company reducing capital is concerned that a creditor cannot demonstrate that a reduction would affect the satisfaction of its claim, it can ask the court to take this factor into consideration.
6. BERR published a consultation on implementation of the provisions in Directive 2006/68/EC in February 2006, the consultation closed on 31st May 2007. There was a small response to the consultation. However respondents indicated that, for purposes of clarity, BERR should amend the requirement in respect of safeguards for creditors to reflect the shift in the burden of proof from the company to the creditor when objecting to a reduction of capital.
7. Therefore in the interests of clarity, we are proposing to implement the requirement in respect of creditor safeguards by 15 April 2008, to ensure that UK is compliant with the shift of emphasis required by the Directive. We aim to introduce the amendment in line with Common Commencement Date of 6 April 2008 for the 1985 Act, and October 2008 for the 2006 Act.

Options for implementing the Companies (Reduction of Capital) Regulations 2008

OPTION 1: Do Nothing

8. This particular provision in the Directive is mandatory and if we do not implement it, we risk non-compliance due to the lack of clarity in respect of existing UK provisions which may in turn lead to infraction proceedings being taken against the UK.

OPTION 2: Amend existing UK law to reflect the mandatory requirement in the Directive.

9. This will provide the clarity that stakeholders required and ensure compliance with the provision in the Directive. Although there will be shift in the burden of proof from the company to the creditor, creditor safeguards will be maintained for those creditors entitled to object and there may be small reduction admin burdens for companies involved in such cases.

COSTS AND BENEFITS

10. **Option 1:** There would be no change in costs and benefits if UK legislation is left unchanged. However, if UK legislation is left unchanged there is risk of non-compliance and infraction proceedings may lead to UK being fined for infraction.
11. **Option 2:** There may be some benefits to companies who would no longer be required by the courts to publish the reasons for a reduction in capital. In 2005, PWC estimated the cost of this burden to be in the region of £544K per year based on 168 applications to the court a year. Provisions which require that the courts do not confirm a reduction unless the consent of those creditors entitled to object has been obtained should ensure creditor protection is maintained.

RISKS

12. UK law already permits creditors to object to capital reduction schemes through the courts. There is, however, no express requirement that, before being granted relief in such circumstances, the creditor must demonstrate that its claim is at risk, as the amending Directive requires. If UK law is not amended lack of clarity may lead to non compliance.

WHO WILL BE AFFECTED?

13. These provisions only to public limited liability companies. There are approximately 38,000 public limited liability companies in the UK (based on figures taken from the FAME database at July 2006).

ISSUES OF EQUITY AND FAIRNESS

14. The Government considers that these measures will not bring disproportionate benefits or have disproportionate affects on particular groups. Although the burden of proof has shifted - creditors still have access to the courts in the case of a complaint.

SMALL FIRMS IMPACT TEST

15. There is no change in nature or number of the overall population of companies affected by these provisions. The shift of the burden of proof from the company to its creditor in the case of a reduction of capital should not adversely affect small companies.

ENFORCEMENT AND SANCTIONS

16. Existing companies act provision apply. The draft regulations remove offences from existing legislation relating to information about creditors (section 141 of the Companies Act 1985 and section 647 of the Companies Act 2006).

CONSULTATION

17. The consultation on the implementation of the amendments to the 2nd Company Law Directive (Simplification of the Capital Maintenance Rules) was published on 28th February 2007. It formed part of Chapter 6 of the consultation on "Implementation of the Companies Act 2006" the consultation process closed on 31 May 2007 the government response is available from BERR website at: <http://www.berr.gov.uk/bbf/eu-company-law/directives/page19528.html>.

COMPETITION ASSESSMENT

18. The competition filter has been applied. It is considered that the Directive will not give rise to disproportionate costs of entry or administrative costs for either small or large business. The Directive is not anticipated to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services.