

**EXPLANATORY MEMORANDUM TO
THE COMPANIES (REDUCTION OF CAPITAL) (CREDITOR PROTECTION)
REGULATIONS 2008**

2008 No. 719

1. This explanatory memorandum has been prepared by the Department for Business, Enterprise and Regulatory Reform and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 Companies seeking to reduce their share capital must apply to the courts. The Companies Act 1985 and the Companies (Northern Ireland) Order 1986 set out a procedure involving the court producing a list of creditors of the company. If this procedure is followed the court must be satisfied, before it approves the capital reduction, that all of the listed creditors have consented to the reduction or have had their claims paid or secured by the company. The court can disapply the procedure if it is satisfied that the company's creditors are adequately protected, and routinely does so. These Regulations amend the Act and the Order to prevent a creditor being eligible to be included in the list of creditors if he or she cannot show a real likelihood that the proposed capital reduction would result in the company being unable to pay his or her claim when it fell due. The court will therefore be able, when seeking satisfaction from a company that its creditors are protected, to disregard the interests of a creditor who is unable to show such a likelihood. The amendments implement changes made to the Second Company Law Directive (Council Directive 77/91/EEC) by Directive 2006/68/EC. They will not interfere with the kind of protection available to creditors who genuinely need protection or with the process by which the courts deal in practice with applications to reduce share capital.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Sections 135 to 141 of the Companies Act 1985 and Articles 145 to 151 of the Companies (Northern Ireland) Order 1986 deal with court-approved capital reductions by limited companies. These Regulations implement the changes made by Article 1(9) of Directive 2006/68/EC to Article 32(1) of Council Directive 77/91/EEC (the Second Company Law Directive), and make the same changes to the law applying to private companies (the Directives only apply to public companies). A Transposition Note is attached at Annex A.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Parliamentary Under Secretary of State, Gareth R Thomas MP, has made the following statement regarding human rights:

“In my view the provisions of the Companies (Reduction of Capital) (Creditor Protection) Regulations 2008 are compatible with the Convention Rights.”

7. Policy background

Policy

7.1 Article 1(9) of Directive 2006/68/EC is intended to enhance standardised creditor protection in all Member States by ensuring that creditors under certain conditions can resort to judicial or administrative proceedings where their claims are at stake as a consequence of a reduction of the capital of a public limited liability company. The conditions are that they can credibly demonstrate that their claim is at stake and that no adequate safeguards have been obtained from the company.

7.2 The Regulations amend section 136(3) of the Companies Act 1985 and Article 146(3) of the Companies (Northern Ireland) Order 1986 so as to ensure that these provisions reflect the change made by Article 1(9) of Directive 2006/68/EC. As a result, creditors of a company will need to be able to show a real likelihood that a proposed capital reduction would result in the company being unable to discharge their debts or claims when they fell due in order to be given protection.

Consultation

7.3 The proposed directive was subject to consultation in the UK during March to June 2005. Small stakeholder groups and roundtables were also established to consider the proposals in the Directive. The government response and a summary of responses to the consultation were published in September 2005.

7.4 The Government consulted on proposals for implementing Directive 2006/68/EC in February 2007. The consultation closed on 1 June 2007. Notice of the consultation was sent to a wide range of interested parties and the consultation document was placed on the Department's website. The government response to the consultation was published on the BERR website in July 2007. There was a small response to the consultation (7). Respondents indicated that for purposes of clarity we should amend the creditor protection requirements to reflect a shift in the burden from the company to the creditor when objecting to a reduction of capital. Draft Regulations were published on the department's website in October 2007 for comment. The final Regulations reflect the outcome of discussions during and after the consultation processes.

8. Impact

8.1 An Impact Assessment on the changes made to implement Directive 2006/68/EC is attached to this memorandum at Annex B.

8.2 These Regulations have no impact on the public sector.

9. Contact

Julie Ford at the Department for Business, Enterprise & Regulatory Reform, and Telephone: 020 7215 2162 or e-mail: Julie.Ford@berr.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Intervention & Options

Department /Agency: The Department for Business Enterprise and Regulatory Reform	Title: Impact Assessment of The Companies (Reduction of Capital) (Creditor Protection) Regulations 2008	
Stage: Final	Version: One	Date: 7 March 2008
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

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

To implement a requirement introduced by Directive 2006/68/EC that the creditors of a public company can only object to a reduction in the company's share capital if they can credibly demonstrate that their claims are at stake as a result of the proposed reduction.

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. Reflect the requirement for creditors to be able to credibly demonstrate that their claims are at stake in order to be able to object to a reduction of capital.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

This policy will be reviewed when dealing with the equivalent provisions in the Companies Act 2006 - planned to come into force in October 2009.

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:

Gareth Thomas

.....Date: 11th March 2008

Summary: Analysis & Evidence

Policy Option:	Description:
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups'
	One-off (Transition)	Yrs	
	£ 0	0	None -in practice the regulations should not lead to any additional costs for any of the parties involved.
	Average Annual Cost (excluding one-off)		
£ 0			Total Cost (PV) £
<p>Other key non-monetised costs by 'main affected groups'</p> <p>The conditions requiring that creditors can only object if they can show a real likelihood that the proposed capital reduction would result in the company being unable to discharge their claims may reduce the number of objections and perhaps reduce cost for the company.</p>			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' There may be a reduction in the number of objections made by creditors. As there is no evidence to indicate that creditors in the UK are in the habit of making spurious claims or that the courts would support them if they did - it is not possible to quantify what if any savings will be achieved.
	One-off	Yrs	
	£	0	
	Average Annual Benefit (excluding one-off)		
£			Total Benefit (PV) £ 0
<p>Other key non-monetised benefits by 'main affected groups' According to Companies House records there are approximately 500 applications to the court for capital reductions per year of which approximately 200 are approved. The regulations will provide improved clarity in the processes for handling objections to reductions in capital.</p>			

Key Assumptions/Sensitivities/Risks
The regulations apply to both public and private limited liability companies.

Price Base Year 0	Time Period Years	Net Benefit Range (NPV) £ 0	NET BENEFIT (NPV Best estimate) £ 0
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	6 April 2008
Which organisation(s) will enforce the policy?	The courts.
What is the total annual cost of enforcement for these organisations?	£ Not known
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?	No	No	N/A	N/A
Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)	
Increase of £	Decrease	£	Net Impact	£

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

The Companies (Reduction of Capital) (Creditor Protection) 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>

OBJECTIVE

2. The Companies (Reduction of Capital) (Creditor Protection) Regulations 2008 amend existing UK legislation to implement Article 1(9) of Directive 2006/68/EC. That Article requires creditors to be able to credibly demonstrate that their claim is at stake in order to be able to object to a reduction in a company's capital.
3. 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. Article 1(9) of the Directive is intended to enhance standardised creditor protection in all Member States, by enabling creditors resort to judicial or administrative proceedings, subject to conditions.

BACKGROUND

4. Under UK law, a public company may reduce its share capital by special resolution, subject to confirmation by the court. The 1985 Act also requires the company to be authorised by its articles of association before it can reduce its capital to protect shareholder interests. UK legislation provides a procedure for identifying and producing a list of creditors entitled to object to a capital reduction. If the procedure is followed the court is required to be satisfied, before it approves the capital reduction, that all of the listed creditors have consented to the reduction or have had their claims paid off or secured by the company. Routinely the court disapplies the procedure on being satisfied by the company that the interests of creditors who would be entitled to object are adequately protected.

5. Directive 2006/68/EC requires creditors to 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”.
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 from the company to the creditor when objecting to a reduction of capital.
7. Therefore in the interests of clarity, we are proposing to amend the existing provisions of UK legislation concerned with creditor protection on a capital reduction, to ensure that they reflect the shift of emphasis in the Directive. We aim to introduce the amendment in line with Common Commencement Date of 6 April 2008.

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

OPTION 1: Do Nothing

8. This particular provision in the Directive is mandatory and if we do not make change to UK law, 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 require and ensure that existing provisions reflect the provision in the Directive.

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:** UK law already permits creditors to object to capital reduction schemes through the courts. However, existing provisions dealing with identifying creditors entitled to object do not contain any express requirement that, before being in a position to be granted relief in such circumstances, the creditor must be able to credibly demonstrate that its claim is at risk, as the amending Directive requires.

RISKS

12. UK law already permits creditors to object to capital reduction schemes through the courts. However, existing provisions dealing with identifying creditors entitled to object contain no express requirement that, before being in a position to be granted relief in such circumstances, the creditor must be able to credibly 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 apply to both public and private limited liability companies. There are approximately 1.6 million companies in the UK. Companies' House records indicate that there are approximately 500 applications from companies each year of which approximately 200 are approved by the courts.

ISSUES OF EQUITY AND FAIRNESS

14. The Government considers that these measures will not bring disproportionate benefits or have disproportionate affects on particular groups. There will be no reduction in the protection for creditors who need protection.

SMALL FIRMS IMPACT TEST

15. The express requirement for creditors to show a real likelihood that their claim is at risk should not adversely affect small companies.

ENFORCEMENT AND SANCTIONS

16. A company seeking a reduction of share capital is required to apply to the courts for approval.

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>. The draft regulations were published on the BERR website for comment

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.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

TRANSPPOSITION NOTE

DIRECTIVE 2006/68/EC AMENDING COUNCIL DIRECTIVE 77/91/EEC AS REGARDS THE FORMATION OF PUBLIC LIMITED LIABILITY COMPANIES AND THE MAINTENANCE AND ALTERATION OF THEIR CAPITAL

The Companies (Reduction of Capital) (Creditor Protection) Regulations 2008

The Companies (Reduction of Capital) (Creditor Protection) Regulations 2008

implement Article 1(9) of Directive 2006/68/EC. Directive 2006/68/EC amends Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital. Article 1(9) of the Directive 2006/68/EC amends the creditor protection provisions in Directive 77/91/EEC.

The amendment must be implemented by 15 April 2008, and the Regulations come into force on the common commencement date of 6 April 2008. This is only mandatory provision in the Directive.

This Article is intended to enhance standardised creditor protection in all Members States by ensuring that creditors under certain conditions can resort to judicial or administrative proceedings where their claims are at stake as a consequence of a reduction the capital of a public limited liability company. The conditions are that they can credibly demonstrate that their claim is at stake and that no adequate safeguards have been obtained from the company.

4. Sections 135 to 141 of the Companies Act 1985 and Articles 145 to 151 of the Companies (Northern Ireland) Order 1986 deal with reductions of share capital by limited companies. A special resolution of the company's members is required and the capital reduction must be approved by the court. The Act and the Order contain provisions designed (where they apply) to protect creditors of the company by allowing them to withhold their consent to a capital reduction unless their claims are paid off by the company or the creditors are safeguarded by the company providing security for their claims. The courts routinely disapply these provisions in practice (as they are entitled to do) on being satisfied that the company in question has adequately protected the interests of those creditors who would be entitled to object. The provisions largely reflect the requirements of the amended Directive, except that they do not restrict the creditors entitled to object to those creditors who can credibly demonstrate that their claims are at stake. The Regulations therefore amend the provisions in question to reflect that requirement

5 The mandatory provisions of Directive 2006/68/EC are dealt with as follows:

Article in Directive	Purpose	Implementation
1 (9)	To standardise creditor protection so that creditors under certain conditions are able to resort to judicial or administrative proceedings where their claims are at stake as a consequence of a	Sections 136 and 137 of the Companies Act 1985 and Articles 146 and 147 of the Companies (Northern Ireland) Order 1986, as amended by the Companies (Reduction of Capital) (Creditor Protection) Regulations 2008. Regulation 2 inserts section 136(3)(b) into the Companies Act 1985 preventing creditors from being

	<p>reduction in the capital of a public limited liability company. The conditions in such cases are that the creditor can credibly demonstrate that their claim is at stake and that adequate safeguards have not been provided by the company.</p>	<p>in a position to object to a capital reduction unless they can show that there is a real likelihood that the reduction would result in company being unable to discharge their debts or claims when they fell due. In deciding whether to disapply section 136(3)(b) under section 136(6), the courts will be able to disregard the interests of creditors who would not be entitled to object. Regulation 3 makes an equivalent amendment for Northern Ireland.</p>
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6. Responsibility for the measures described in this transposition note taken to implement the amendment made by Directive 2006/68/EC lies with the Secretary of State for Business, Enterprise and Regulatory Reform.

Department for Business, Enterprise and Regulatory Reform

7 March 2008