Protection Measures for Creditors in the Case of Illegal Capital Reduction

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Abstract: In order to standardize the company's capital reduction behavior, the new Company Law has innovated the capital reduction procedures and the legal consequences of illegal capital reduction, defined the necessary procedures of the company's capital reduction, clarified that the illegal capital action is invalid, and added the compensation liability of shareholders and executives with illegal capital reduction. However, the absolute invalidation of illegal capital reduction stipulated by the new law may hinder the benign development of the company. The relief of creditors' objection failure is missing, and the duty of care of shareholders and executives to assume responsibility is not explained in detail. Through the comparative analysis of the old and the new laws, the interpretation of the text and the interpretation of value sorting, combined with the judicial practice of the shareholders taking the responsibility, this paper studies how to improve the legislation, establish the legitimacy of the capital reduction procedure, refine the effectiveness of illegal capital reduction, and specify the duty of care and diligence of shareholders and senior executives. Only by improving the legislation can we protect the interests of creditors to the greatest extent on the premise of respecting the corporate autonomy.

Keywords: Violation of Capital Reduction; Liability of Shareholders; Capital Reduction Procedure; Effectiveness of Capital Reduction

1. The Company's Illegal Capital Reduction Damages the Interests of Creditors

Capital reduction refers to the behavior of reducing the registered capital of the company. The registered capital of the company is the guarantee for the company to bear civil liabilities externally. The reduction of the registered capital means the reduction of the company's external guarantee ability. Therefore, the capital reduction may have a significant impact on the interests of the creditors of the company. [1] The Company Law stipulates the necessary procedures for capital reduction of the company, but it does not stipulate the responsibility subject and legal consequences of illegal capital reduction. Lack of legal regulation, the company arbitrarily reduces capital reduction and illegal capital reduction phenomenon frequently occurs. The creditors of the company lose the right to pay off debts or provide security due to the notice of capital reduction, which damages their own interests .[2] Due to the lack of legislation, local courts have different judgments in such cases, and most of the shareholders withdraw the capital reduction shareholders bear the corresponding responsibility. However, there is a conflict between such judgments and shareholders' limited liability, and in practice, there will be unfair compensation for creditors. The premise that creditors need special protection is that the company's illegal capital reduction leads to the company's insufficient solvency. If the company's property is sufficient to pay off debts, there is no need to apply special protection for creditors through legislation or analogy. Therefore, this paper only discusses the protection measures for creditors in the case of insufficient solvency caused by the company's illegal capital reduction.

There are a lot of legislative and practical experience on illegal capital reduction. For instance, British law is very strict, with the double consent of the court and creditors, if the company conceals debts or misstated debts, the court will confirm that the capital reduction is invalid, capital reduction shareholders must return the capital reduction, in the process of capital reduction intentionally or negligently conceal the debt situation of the executive may

also constitute a crime. Germany, Korea and Japan take the performance of the creditor's objection procedure as the effective requirement of capital reduction. Australia and the United States have relatively loose regulations on capital reduction, emphasizing the responsibility of directors in the capital reduction process. [3]

The newly implemented company Law defines the necessary procedures for the illegal capital reduction, clarifies that the illegal capital reduction is invalid, and adds simple capital reduction procedures and the compensation liability of shareholders and executives who violate the capital reduction. However, the new company law stipulates that illegal capital reduction is absolutely invalid and may hinder the benign development of the company. The legal consequences of creditors' right of objection are not clear, and the duty of care of shareholders and executives is not explained in detail. Therefore, it is necessary to deeply study the provisions of the Company Law on the violation of capital reduction, establish the legitimacy of the procedure, refine the application of the illegal reduction of capital, and clarify the responsibility premise and legal consequences of the diligence obligations of shareholders and executives, so as to protect the interests of creditors to the greatest extent on the premise of maintaining and respecting the corporate autonomy.

2. The Cause of the Problem

The Company Law stipulates that a company reduces its registered capital should prepare a balance sheet and property list. The company shall notify the creditors within 10 days from the date when the shareholders' meeting makes the resolution to reduce the registered capital, and announce the announcement in the newspaper or the national enterprise credit information publicity system within 30 days. The creditor shall, within 30 days from the date of receipt of the notice, and within 45 days from the date of the announcement of the notice, have the right to demand the company to pay off debts or provide corresponding guarantees. When the company reduces its registered capital, it shall also handle the alteration registration with the company registration authority according to law. Although the company law stipulates that the capital reduction must comply with the above necessary procedures, but there is no provision for the reasons for capital reduction, the procedure requirements are simple and with a certain ambiguity. In addition, the Company Law only stipulates administrative penalties for the violation of capital reduction. If the company fails to notify or announce the creditors in accordance with the provisions of this Law, the company registration authority shall order it to make corrections and impose a fine of more than 10,000 yuan and less than 100,000 yuan on the company. But the action procedure without the reason, still by the company to decide whether the action is optional, no clear type of creditors cannot guarantee the expected interests of the unknown creditors, the announcement way can not guarantee the creditors, no other relief way, the new simple capital does not even give the creditors right of objection.

2.1 The Legislative Content of the Capital Reduction Procedure is Not Clear Enough

There is no reason for capital reduction. The legislation respects the autonomy of the company, and there is no specific regulation on the reasons for capital reduction. As long as the general meeting of shareholders is approved by the shareholders representing more than two-thirds of the voting rights, it causes the company's random and frequent capital reduction, causes the company's capital to enter into an unstable state, and affects the trust interests of market transactions.

No clear type of creditor exists. Creditors are divided into known creditors and unknown creditors. It can be known from the provisions that the creditors of the company to notify within ten days from the date of the capital reduction resolution are known creditors, and the purpose of publicity is to inform the unknown creditors. In order to more protect the interests of the creditors, before the resolution has not clearly formed the creditor's rights, as long as there is a clear creditors, even if the amount has not been determined, but as long as the two parties have signed a contract and has actually perform the rights and obligations, should also be covered by

known creditors, have the right to resolution within ten days after receiving notice and demand.

There is no clear way of making the announcement. The new company law stipulates that the company's capital reduction should be announced in the newspaper or the national enterprise credit information publicity system within 30 days. But the traditional newspaper announcement is obviously not suitable for contemporary reading habits, the company may choose small audience narrow level of newspaper, and the regulation is not mandatory must be in the national enterprise credit information publicity system announcement, but the selective announcement, will make the public system announcement program into decoration, can not really achieve the purpose of looking for unknown creditors.

There is no clear right of objection of the creditors. When the creditor asks the company to pay the debt or provide security is refused, or no notice at all.

2.2 Legislation Lacks the Regulation of the Legal Consequences of Illegal Capital Reduction

Illegal capital reduction is absolutely invalid and may hinder the benign development of the company. Since the company law has set up the necessary pre-procedure for capital reduction, the capital reduction action that violates the procedure should be invalid. Before the introduction of the new Company Law, according to the existing laws and judicial interpretation, the court will not take the initiative to confirm that the illegal capital reduction is absolutely invalid, but by avoiding the effectiveness of the default capital reduction is relatively invalid. This kind of judgment idea draws on the legislative practice of Taiwan in China, that is, the illegal capital reduction "shall not confront creditors" (Article 74 of the Company Law of Taiwan), and requires shareholders to bear the liability of supplementary compensation to creditors within the scope that the company cannot pay off debts. [3] In addition, if the company has handled the registration of change, the registration of change will not change due to the judgment, in fact, the capital reduction action is still effective. The establishment of the invalid system of capital reduction is a big innovation of the new Company Law. If the capital reduction seriously violates the legal procedures or substantive conditions, the relevant interests may request the court to find the capital reduction invalid. Once the capital reduction is confirmed to be invalid, the company shall return the capital reduction money to the shareholders, and bear the compensation liability for the losses of the creditors. The value of the ineffective system of capital reduction lies in that it provides a relief channel for all parties after the event, and strengthens the role of justice in correcting illegal capital reduction and protecting the rights and interests of all parties. But the absolute invalidity may hinder the healthy development of the company. [4]

The duty of care of shareholders and the duty of diligence of senior executives need to be refined. The capital reduction resolution is made by the shareholders' meeting, and the creditors, the announcement and the capital reduction change procedures are operated by the senior executives, but the Company Law only stipulates a certain amount of administrative punishment for the company that violates the capital reduction. Although the new Company Law stipulates that if the illegal capital reduction causes losses to the company, the shareholders and the responsible directors, supervisors and senior management personnel shall bear the liability for compensation, but there are no specific applicable circumstances. The absence of this part will encourage shareholders to make malicious capital reduction decisions and executives to notify creditors. [5]

There are no clear legal consequences. Because there is no provision for the legal consequences of illegal capital reduction, the court's judgment is different in practice. Some judgment shareholders are not responsible, some created in the case judgment did not notify the creditors "shall not against the creditors" rule (or so on, the withdrawal of investment rules).

2.3 The Duties of the Company Registration Authority are Not Clear

If a company fails to notify or announce creditors in accordance with the provisions of this Law, the company registration authority shall order it to correct and impose a fine of

more than 10,000 yuan but not more than 100,000 yuan on the company. If the contents of the correction are not clear, should it be understood as "canceling the change of capital reduction" or "completing the obligation of notice and announcement"? In addition, the registration authority and the court are independent of each other and do not interfere with each other. In the case that the court does not find that the capital reduction behavior is invalid, in addition to the company's active application for cancellation, the registration authority has no reason and basis to cancel the company's capital reduction change.

3. Measures to Solve

3.1 Improve Legislation

Clear legislation is the basis of regulating the company's capital reduction behavior. A clear responsibility subject and the consequences of the behavior can fundamentally obstruct the shareholders with malicious capital reduction, urge the company's senior executives to fulfill their fiduciary obligations, achieve legal and compliant capital reduction, and reduce the damage to the company and creditors.

3.1.1 Improve capital reduction procedures

Provide for the reasons for capital reduction. In reality, the company's capital reduction is arbitrary, as long as the shareholders make an absolute majority resolution. The reason that most companies reduce capital is loss, revitalize redundant capital, but whether the degree of loss reach the point that must reduce capital? The legislation should stipulate the specific reasons and degrees, such as the company's loss reaches the specified proportion or amount for five consecutive years, and the excess capital has not been used and activated in the specific proportion within three years.

Clarify the type of creditors. Clear creditors to notify within 10 days, in order to more protect the interests of the creditors, before the resolution of the formation of creditor's rights, as long as there is a clear creditors, even if the amount has not been determined, but as long as the two parties have signed the contract and actually perform the rights and obligations, should also be covered by known creditors, have the right to resolution within ten days after receiving the notice and demand.

Clarify the way of notice and announcement. Direct service shall be used to known creditors, such as writing, mail, instant messaging, etc. For unknown creditors, the announcement shall be made at the municipal level or above or at the same time as the local level and the national enterprise credit information publicity system.

Clarify the creditors' right of objection. When the creditor requests the repayment or the guarantee is rejected, or the creditor has not received the notice at all, it shall have the right to raise an objection to the company registration authority, and the capital reduction shall continue only after the creditor's rights have been paid off.

3.1.2 Clarify the applicable conditions of illegal capital reduction

The civil Code stipulates that a civil legal act that violates the mandatory provisions of the effectiveness of laws and administrative regulations is invalid, and the Company Law stipulates that the capital reduction must go through the procedure of notice and announcement. If the notice and announcement are not completed, the effect of the capital reduction shall be invalid. In the trial, the court should first determine that the illegal capital reduction is invalid, which is also the basis for the determination of the subsequent shareholder responsibility and senior management responsibility. Article 226 of the New Company Law makes it clear that illegal capital reduction is absolutely invalid, reduces the cost and difficulty of the argument at the interpretation level, and directly corrects the interest imbalance under the previous relatively ineffective path, which also constitutes the logical starting point for the subsequent responsibility allocation. [6] However, if the company only has some minor defects in the process of capital reduction, such as failure to notify some creditors, or refuse creditors' repayment or guarantee requirements, but the actual assets of the company are sufficient to pay off the debt, or failure to strictly comply with the 30-day announcement period. If the company still has the solvency after the capital reduction, if the capital reduction is determined to be absolutely invalid due to the above procedural defects, it may hinder

the benign development of the company. Therefore, in this case, the minor defect exemption concept of article 26 of the Company Law can be used to limit the invalid reasons of capital reduction. The discretionary rejection system of minor defects in China originates from Article 4 of the Provisions of the Supreme People's Court on the Application of Several Issues of the Company Law of the People's Republic of China (IV), which draws on the legislative experience of comparative law and aims to realize the balance between the overall interests of the company and the individual interests of the right holder. [7]

3.1.3 Improve the responsibility basis of shareholders and senior executives under the illegal capital reduction

Shareholders' obligation of care premise. On the basis of determining that the violation of capital reduction is invalid, the registered capital shall be restored to the original state, that is, the shareholder shall return the funds it has received, and the shareholder's investment shall be restored to the original state. Since the shareholders do not fulfill the necessary duty of care and supervision in the process of illegal capital reduction, the shareholders with the capital reduction in the capital reduction shall bear the supplementary compensation liability for the insolvent debts of the company within the scope of capital interest reduction. In addition, the company's illegal capital reduction and the shareholders' withdrawal of investment are extremely similar, and the legal consequences of the illegal capital reduction are similar to the legal consequences of the shareholders 'withdrawal of investment, and the shareholders shall bear the supplementary compensation liability for the part of the company's debt that cannot be removed. [8]

Exemption of shareholders who fail to vote in favor of the capital reduction. The capital reduction matters shall be approved by the absolute majority of the shareholders' general meeting. According to the minutes of the shareholders' meeting, the shareholders are divided into yes and no affirmative votes. The shareholders who vote in favor are responsible for the illegal capital reduction, while the shareholders who do not participate in voting, oppose or abstain are not responsible for the illegal capital reduction. Further, the shareholders who vote in favor are divided into capital reduction shareholders and not capital reduction shareholders. The capital reduction shareholders and the shareholders who vote for the capital reduction assume joint and several liability externally, and the shareholders who do not reduce the capital internally can recover from the capital reduction shareholders. [8]

The maturity of the outstanding investment period is accelerated. [9] In principle, the shareholders without the term of investment shall enjoy the benefits of the term. Even if the capital reduction is invalid and restore the obligation of investment, they will be exempted from liability because it does not actually affect the solvency of the company. [10] We can refer to the minutes of the Nine People's Meeting (abolished) on whether the maturity of shareholders' capital contribution should be accelerated: on the grounds that the company cannot pay off the debts due, the shareholders requesting the term to bear supplementary liability for the debts within the scope of the unpaid capital contribution, it shall not be supported. Except in the following circumstances: (1) the company, as the person subject to execution, exhausted the execution measures with no property to execute, and has reasons for bankruptcy but does not apply for bankruptcy; (2) the term of the shareholders' capital contribution after the debts of the company. If the shareholders in the term of the investment do not fulfill the necessary duty of care and supervision for the illegal capital reduction, and have intentional or negligent reasons for the illegal capital reduction, the term of the capital contribution may be regarded as the accelerated expiration. In the case of the accelerated maturity of the term of capital contribution, the shareholders shall bear the supplementary liability for the compensation of the part of the company that cannot be repaid within the scope of the outstanding capital interest.

The board of directors is responsible to the shareholders' meeting, and the exercise of its functions and powers includes the formulation of plans for the increase or decrease of the registered capital of the company and the issuance of corporate bonds. The board of directors, as the executive body of the power

of the company, formulates the capital reduction plan according to the capital reduction resolution made by the shareholders' meeting, and submits it to the directors or senior executives for specific implementation. When determining that shareholders are jointly and severally liable to the company or creditors, usually directors and executives will be jointly and severally liable with shareholders for assistance or failure to fulfill the duty of care. Directors or senior executives are responsible for the management and operation of the company, and are the people who know the claims and debts of the company best. They are obliged to eliminate the obstruction of shareholders and complete the obligation of notifying creditors and making announcements. Increasing the responsibility of senior executives under the illegal capital reduction is conducive to urging them to complete the obligation of notice and announcement, and the responsibility of senior executives does not need to be based on the existence of the shareholder responsibility, but can exist separately from the shareholder responsibility.

3.2 Improve the Supporting Measures of the Company Registration Authority

Creditors' objection registration. Noting creditors and paying off or providing guarantee is the most important part of the capital reduction process, and it is also the key to judge the compliance of the capital reduction. However, due to the unopenness of commercial behavior, the registration authority's examination of the capital reduction procedures is limited to formal examination. In addition to requiring the company to provide the necessary materials, the company is usually required to issue the "Notes on Debt Settlement and Guarantee", and requires the shareholders to sign the creditor's rights guarantee statement for future reference. During the publicity period, if any creditor raises an objection, the registration authority shall conduct an examination and require the company to explain. If the company is unable to reasonably explain or provide a statement of the capital reduction within the time limit, the application for capital reduction change may be rejected.

Strengthen the linkage mechanism between the company registration authority and the court. In the case of invalid judgment of the company, the court may transfer the effective judgment to the company registration authority, and the registration authority can directly revoke the capital reduction change of the company accordingly, so as to keep the appearance of the business consistent with the actual situation, and maintain the prestige of publicity and public trust. [3]

4. Shortcomings

4.1 The Rationality of the Shareholder Responsibility in the Illegal Capital Reduction

The independent personality and the limited liability of shareholders are the basic concept and foundation of the company law. At present, there are only four kinds of situations that can break through the limited liability of shareholders, namely, defective investment, abuse of legal personality independence, withdrawal of capital contribution and liquidation. The above four kinds are individual behaviors of shareholders, and the shareholder limited liability system to infringe the interests of the company and creditors is essentially infringement, and the shareholders are judged to bear joint and several liability according to the general fault principle. However, the capital reduction of the company is the behavior of the company, and the capital reduction resolution is transformed into the will of the company by the shareholders' meeting. The specific operation is the directors or senior executives of the company, and the shareholders do not directly participate in the capital reduction process. The main subject of responsibility is an important part of the norm, and there may be specific deviations in the similar application of the same legal consequences. In the absence of clear legal provisions, the practice of hastily blaming the legal consequences of the company's behavior to shareholders is questionable.

4.2 Capital Attribution and Unfair Compensation

The Civil Code stipulates that the invalidation of civil legal acts should be restored to the original state, so the invalidation of illegal capital reduction shall restore the registered capital, that is, the shareholders shall return the capital, or the investment obligation shall be

restored, and the final capital belongs to the company for unified arrangement and repayment. The similarities between shareholders 'responsibility and the right of subrogation lie in that they request the other party to perform their obligations to others to themselves. The difference lies in the nature that the two creditor's rights in the subrogation right are the same, and the nature of capital contribution obligation and creditor's rights is different. Although both are subject to money, the causes and the statute of limitations are different. On the issue of unfair compensation, first, the law does not protect the right to sleep, and the first creditor should be protected first. Secondly, after all, capital reduction is different from bankruptcy. If the company still operates normally after capital reduction, the company's property is still likely to increase, and the claims of other creditors are still possible to be realized. The court can seek other creditors to merge the trial on the basis of the consent or priority of the plaintiff, so as to improve judicial efficiency and save judicial resources.

4.3 Applicability of the Shareholder's Claim Security Statement

When the registration authority accepts the company's application for capital reduction, it will usually require the issuance of the "Relevant Debt Settlement and Guarantee Description", and require the shareholders to sign the creditor's right guarantee statement for future reference. In practice, the basis of claiming the shareholders' liability exists. Look from use purpose, guarantee statement is to deal with capital reduction change registration and issue, not for guarantee purpose. From the way of publicity, the guarantee statement is only stored in the industrial and commercial documents, not publicized to the public, nor is it served to the clear creditors, and the expression of guarantee intention does not reach the creditors. [11] In terms of content, the guarantee statement only generally indicates that the shareholders provide guarantee for the company's outstanding debts, does not specify the guarantee object and guarantee amount, and does not have practical operation. The creditor takes the guarantee statement as the basis to claim the joint liability of shareholders obviously lacks factual and legal basis.

5. Peroration

Violation action weakened the company's solvency, not notify the creditors damage the interests of the creditors, it is necessary to improve the relevant legislation, confirm the effectiveness of the action, aggravating the action of shareholders and executives did not fulfill their fiduciary obligations, strengthen the linkage of the company registration authority and the court, to reduce the violations of the action, maintain the company's capital is relatively stable, to deal security and protect the interests of the creditors.

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