Safeguarding Creditors in the Course of Simplified Reduction of Subscribed Capital

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Abstract

The central characteristics of simplified subscribed capital reduction are its very narrow purpose, and a weakened regime of safeguarding of creditors. The main and, frankly, only purpose of the institution is recovery. It is namely most difficult to expect from a distressed company undergoing simplified subscribed capital reduction, which is first and foremost intended for recovery, to safeguard its creditors in the same extent as in the case of ordinary reduction of subscribed capital. The article provides an analysis of the intent and purpose of simplified subscribed capital reduction and the regulations governing the safeguarding of creditors. Using a descriptive method, subject matter analysis, and comparative legal analysis of the issue, the article elaborates on why regulations governing the safeguarding of creditors are too weak with regard to the effects brought forth by this type of subscribed capital reduction and proposes appropriate supplementation and amendments to applicable legislation.

Keywords: simplified subscribed capital reduction, safeguarding of creditors, capital inadequacy, payment ban, tied assets

1 Introduction

The central characteristics of simplified subscribed capital reduction are the direct opposite of characteristics of an ordinary subscribed capital reduction: a narrow aim and purpose, and a weakened regime for safeguarding of creditors (compared to safeguards applied in ordinary subscribed capital reduction). The main and only purpose of this specific type of capital reduction is the recovery of a distressed company. The law breaks down the institution into three specific purposes: covering of carried-forward loss, covering of fiscal year net loss, and reallocation of assets from subscribed capital to capital reserves (first paragraph of Article 379 of ZGD-12). It is namely difficult to expect from a company in financial distress, which is undergoing simplified subscribed capital reduction with the sole purpose of recovery, to uphold the same creditors safeguarding regime as with ordinary subscribed capital reduction. Maintaining a broad extent of safeguards for the creditors would hinder the recovery of the company, while on the other hand—at least in most cases—resulting in a disproportionate infringement of the position of creditors, who are already at risk due to the losses realized by the company,

1 For details with regard to ordinary subscribed capital reduction, see Drnovšek (2012 and 2013).

not only (or, more accurately not as late as) the subscribed capital reduction. The reduction is namely executed in order to adjust the amount of subscribed capital to the (already) reduced financial position of the company, or to reallocate subscribed capital to another category of tied-up capital, and does not result in (additional) reduction of assets (on grounds of reducing the subscribed capital).\footnote{Cf. Oechsler in Münchener Kommentar (Goette et al., 2011, § 229, line number (hereinafter: l. no.) 1, 4); Lutter in Kölner Kommentar (Zöllner et al., 1995, Vorb. § 229, l. no. 1).} With regard to simplified subscribed capital reduction, the recovery effect is achieved by transferring predetermined amounts from the categories of subscribed capital, capital reserves and reserves from profit into balance sheet items referred to in the first sentence of the first paragraph of Article 379 of ZGD-1.\footnote{Accord with reference to German law Oechsler in Münchener Kommentar (Goette et al., 2011, § 229, l. no. 6).} As there is no fresh (external) capital injection, legal theory also refers to the institution as “book recovery”.\footnote{Oechsler in Münchener Kommentar (Goette et al., 2011, § 229, l. no. 6); Wirth (1996, p. 867). Cf. Schmidt (1982, p. 520); Kocbek in Korporacijsko pravo (Ivanjko et al., 2009, p. 729).}

The simplification of the subscribed capital reduction, as opposed to the ordinary reduction, is seen from the first paragraph of Article 379, and from the reference stipulated by the third paragraph of Article 379 of ZGD-1. The former restricts the aim and purpose of the institution and thus takes away some of the authority of the general meeting which the latter holds in case of ordinary subscribed capital reduction. On the other hand, the released amount of the subscribed capital is easier to utilize, since it does not fall under the time-consuming regime of safeguarding of creditors, stipulated by Article 375 of ZGD-1 (the third paragraph of Article 379 of ZGD-1 namely fails to reference the aforementioned provision).\footnote{Cf. Kocbek in Korporacijsko pravo (Ivanjko et al., 2009, p. 729).} Since the safeguarding regime does not apply, as is the case with ordinary subscribed capital reduction, the execution of the measure may largely be accelerated.

Weakened safeguarding of creditors does not mean that the legal regulation is disregarding the interests of creditors, since their interests are safeguarded in a different manner—a manner more suitable for the institution of simplified subscribed capital reduction. However, the safeguarding regime only goes half way, as the protection, such as currently constructed, is too weak. The forgoing thesis will be elaborated on and proven by means of descriptive method and subject matter analysis of the regulation of safeguarding of creditors in the course of simplified subscribed capital reduction. The findings will be additionally fortified by means of comparative analysis of the regulation in the German legal environment.

2 Recovery and Covering Losses

Pursuant to the second paragraph of Article 379 of ZGD-1, simplified subscribed capital reduction is admissible only if, after prior utilization of net profit and carried-forward profit and after the release of appropriate reserves from profit and capital reserves, the company has at its disposal statutory reserve-fund, the amount of which does not exceed the maximum amount prescribed by the law (10%, as per the third paragraph of Article 64 and first indent of the second paragraph of Article 379 of ZGD-1) or corporate charter, which is to be determined on grounds of the new (reduced) amount of subscribed capital.\footnote{For assumptions and requirements of simplified subscribed capital reduction in continental legal systems in general, see Bratina, Jovanovič, Podgorelec, Primec (2011, p. 674).} Such a threshold is stipulated also by the first point of the tenth paragraph of Article 64 of ZGD-1, which governs the utilization of statutory\footnote{Statutory reserves are the reserves referred to in the first indent of the second paragraph of Article 64 of ZGD-1 (Liabilities and Equity A. III. 1.).} and capital reserves at the point of preparation and adoption of the annual report in cases when statutory reserve-fund does not exceed the threshold stipulated by the law or corporate charter. In the aforementioned instance, statutory and capital reserves may be utilized to cover the net or carried-forward loss only if the losses cannot be covered by carried-forward or net profit, or by corresponding (equal) reserve and profit categories. It is thus possible that both situations arise simultaneously, i.e. the situation referred to in the first point of the tenth paragraph of Article 64 of ZGD-1, and the one referred to in the second paragraph of Article 379 of ZGD-1. In such an instance, no situation has priority over the other, since the law leaves the decision whether to utilize the last available reserve (as per the first point of the tenth Paragraph of Article 64 of ZGD-1) or reduce the subscribed capital (as per Article 379 of ZGD-1) to the company.\footnote{By reference to the third paragraph of § 150 and § 229 of the German AktG (“Aktiengesetz”), accord Oechsler in Münchener Kommentar (Goette et al., 2011, § 229, l. no. 33). Cf. Wirth (1996, p. 869 (left line)).}

By allowing for simplified subscribed capital reduction even when the company (still) has at its disposal statutory reserve-fund, the amount of which (determined on grounds of reduced subscribed capital) does not exceed the threshold stipulated by law or corporate charter, the regulation
clearly suggests that capital inadequacy is not a mandatory requirement for the execution of simplified subscribed capital reduction. In case the company realized a loss equal (at most) to such amount of statutory reserve-fund, and the company has no other available reserves which could be utilized to cover the loss, capital inadequacy is not given, whereas it is still admissible to reduce the subscribed capital in order to cover the loss. In all likelihood, the company will decide to cover the loss by means of simplified subscribed capital reduction (only) after capital inadequacy occurs.

2.1 Defining loss and time

Article 379 of ZGD-1 uses the following terms: “carried-forward loss”, “fiscal year net loss”, “fiscal year net profit”, and “carried-forward profit”. The wording of the law may lead a casual reader to erroneously assume that simplified subscribed capital reduction may only be used to cover the loss of the (full) fiscal year or used only to remedy the balance disclosed in the annual balance sheet (balance sheet as at the last day of the fiscal year; cf. fourth indent of the fourth paragraph of Article 53 of ZGD-1). However, such a superficial interpretation of the law does not pass even the most basic grammatical test. The reasons why the aforementioned assumptions are false are the following:

a) The awkward wording of Article 370 of ZGD-1 is nothing but a (useless) nod to the wording of the law with regard to general regulations governing balance sheet law (Part I, Chapter 8; cf. only Article 64 and Article 66 of ZGD-1), and does not denote a content-related restriction of the applicability of simplified subscribed capital reduction. The term “fiscal year net loss” should not be understood verbatim, and the term “carried-forward loss” should not be understood as only the carried-forward loss disclosed in the annual balance sheet. Even special provisions of ZGD-1 governing subscribed capital reduction cannot sufficiently support the assumption that simplified subscribed capital reduction can only be applied as per the annual balance sheet cut-off date, since ordinary subscribed capital reduction allows for the covering of losses and reallocation of assets to capital reserves as well. It is thus completely illogical that such a restriction is foreign to the freedom arising from the intent and purpose of ordinary subscribed capital reduction, which, by definition of the law, is primarily intended for recovery, only to the balance at year-end and thus forcing the company (in need of recovery) to maintain its distressed position, deepen its loss and wait for some “magical moment”. In simple terms: the aim of Article 60 of the ZGD-F amendment (enacted in 2001) was not to change the content-related applicability of subscribed capital reduction. The aim of the changed provision, which, unfortunately, resulted in a grand failure, was to harmonize the terminology (the omission of the wording “compensate for lower value of assets” is not relevant to this analysis).

b) According to ZGD-1, the concentration of effects of simplified subscribed capital reduction to the last day of the past fiscal year (fiscal year which ended prior to the decision on subscribed capital reduction) is impossible. Simplified subscribed capital reduction becomes effective with the registration of the decision on reduction into the court registry (third paragraph of Article 379 in relation with Article 374 of ZGD-1), whereas the reduction cannot have retroactive effects, i.e. cannot apply to the cut-off date of the balance sheet of the past fiscal year, and thus cannot change the (possibly previously adopted) annual report.

In other words, if the decision on executing a simplified subscribed capital reduction in order to cover the loss is not taken by the general meeting, which is to be held on the cut-off date of the annual balance sheet (see below), simplified subscribed capital reduction cannot be used to cover the fiscal year net loss, since the net loss will turn into carried-forwards loss on the very next day.


13 Prior to the ZGD-F amendment, the first sentence of the first paragraph of Article 354 of ZGD-1 read: “Reduction of subscribed capital aiming to compensate for lower asset value, cover losses or reallocate assets to reserves, may be executed in a simplified manner.” After the enactment of the ZGD-F amendment (Article 60), the provision read: “Reduction of subscribed capital reduction aiming to cover carried-forward loss or fiscal year net loss or reallocate assets to capital reserves may be executed in a simplified manner”. Currently, the first sentence of the first paragraph of Article 379 of ZGD-1 reads as follows (practically unchanged): “Reduction of subscribed capital aiming to cover carried-forward loss or fiscal year net loss or reallocate assets to capital reserves may be executed also in a simplified manner.”

14 For retrospective effects of simplified subscribed capital reduction in German law see § 234 of the German AktG.
c) A concentration of effects arising from simplified subscribed capital reduction executed on the last day of the past fiscal year may lead to the very same consequences (effects) which the second paragraph of Article 379 of ZGD-1 intends to prevent. If, during the period since the end of the past fiscal year until the decision on simplified subscribed capital reduction, the company realized profit which may be utilized to cover the loss, either partially or fully, simplified subscribed capital reduction is not permissible for that amount of the loss (perhaps even the full loss) which the company is able to cover with the realized profit.15

2.2 Determining loss and quality of loss

The loss to be covered with simplified subscribed capital reduction shall exist at the time of the general meeting decision.16 The reason why the loss was realized and the amount of the loss are irrelevant,17 however, the quality of the loss needs to justify the intended permanent change of subscribed capital.18 Relevant quality of the loss is not given, if, e.g., the company discloses a loss which may be quickly remedied by future gains.19 Simplified subscribed capital reduction is thus not based solely on absolute facts, but rather, to a certain extent, also on projections of the management, which need to be drawn up with sufficient diligence.20

The loss does not need to be determined in the formal annual report, and the annual report—even a previously audited and finally adopted report—cannot serve as grounds for simplified subscribed capital reduction as long as there is a chance that the company realized profit in the meantime.21 Statutory provisions governing simplified subscribed capital reduction do not provide any instructions on how to determine the loss, or instructions on the disclosure of the loss in financial statements. As a result, simplified subscribed capital reduction does not need to be based on a formal, previously drawn up balance sheet disclosing the loss which needs to be covered.22 A diligent assessment and projection of the management are fully sufficient.23 In practice, the management would still draw up an interim balance sheet in order to quantify the loss and determine the categories stipulated by the second paragraph of Article 379 of ZGD-1. However, the balance sheet does not need to be audited (despite the company potentially being obligated to audit its annual report), or adopted in any formal manner24 (e.g., by the supervisory board). The obligation to draw up an interim balance sheet, which would need to be presented to the general meeting when deciding on simplified subscribed capital reduction, is not prescribed even by Article 19 of the Decree on the registration of companies and other legal entities in the register of companies.25 The management may draw up the balance sheet referred to in the second point of Article 19 of the Decision even after the general meeting decision (and will be obligated to do so, since the management will need to present relevant items as at the date of decision of the general meeting).

3 Aim and Purpose of Reduction of Subscribed Capital

If the position of creditors is endangered (already) by a negative development of the company’s financial position, (subsequent) recovery is only to their benefit. The peremptory nature of the aim of simplified subscribed capital reduction and its strict limitation to recovery purposes is thus instituted with the main objective of safeguarding the creditors. Instead of directly safeguarding the claims of creditors of the company (as is the case with ordinary subscribed capital reduction pursuant to Article 375 of ZGD-1), the institution of simplified subscribed capital reduction is aimed (solely) at the improvement of the financial position of the debtor (company).26 The very concept of simplified subscribed capital reduction is thus based on the irrefutable assumption that the measure is beneficial,
or at least, neutral, to creditors.\textsuperscript{27} Assets released by the reduction shall therefore be utilized only for recovery purposes (cf. first and second paragraph of Article 379 of ZGD-1), whereas no payments to shareholders are permitted. Even dividend payments from future profits (and other disposal of distributable profit) are restricted (Article 380 of ZGD-1).

### 4 Payment Ban, Fulfilment of Intent, and Tied Assets

With regard to simplified subscribed capital reduction, the main replacement for Article 375 of ZGD-1 is provided by the ban on utilization of released assets for payments to shareholders (released assets shall not be used for payments to shareholders or used as a waiver of the shareholders’ obligation to pay contributions).\textsuperscript{28} Released assets (first and second paragraph of Article 379 of ZGD-1) shall be utilized only for the fulfilment of the primary intent and purpose of simplified subscribed capital reduction (first paragraph of Article 379 of ZGD-1). However, the law fails to provide any specific provisions on the latter (as, e.g., § 230 of the German AktG) in the part referring to the simplified reduction of subscribed capital (Articles 379 and 380 of ZGD-1). The aforementioned rule is the result of a very narrow and restrictive intent and purpose of simplified subscribed capital reduction (first paragraph of Article 379 of ZGD-1), and (general) rules on preservation of capital (first paragraph of Article 227 and eighth paragraph of Article 230 of ZGD-1) which still apply to simplified subscribed capital reduction. In other words, while in case of ordinary subscribed capital reduction the repayment of contributions is admissible and even common practice, payments in case of simplified subscribed capital reduction are never admissible. The amount of tied-up capital is not changed due to simplified subscribed capital reduction.\textsuperscript{29} With regard to released assets and safeguarding of creditors, it is therefore sufficient to denote that the assets concerned shall only be utilized to fulfil a narrow and restrictive (admissible) intent and purpose. Moreover, the law, at least partially, remedies the disadvantages for creditors which arise from the abrogation of contingent subscribed capital (Article 380 of ZGD-1).\textsuperscript{30} As a means of remedying the haircuts to the basic guaranteed asset base, the regulation calls for the accelerated channeling of profit to tied-up reserves. By allowing the utilization of released assets only for the fulfilment of intents and purposes stipulated by the first paragraph of Article 379 of ZGD-1, the law prevents the general meeting from releasing an excessive amount of subscribed capital in order to create available assets for payments to shareholders.\textsuperscript{31}

#### 4.1 Force and extent of tying nature of assets

The narrow purpose and the ban on channeling assets to shareholders applies to all released assets: statutory reserves and other reserves from profit (first indent of the second paragraph of Article 379 of ZGD-1), capital reserves (first indent of the second paragraph of Article 379 of ZGD-1), net profit and carried-forward profit (second indent of the second paragraph of Article 379 of ZGD-1), and the released amount of subscribed capital (first paragraph of Article 379 of ZGD-1). The authority of the management to utilize released assets is limited as well, since the management is obligated to adhere to relevant statutory provisions and to the resolution of the general meeting (with regard to the latter, cf. Article 267 and the second paragraph of Article 285 in relation with Article 267 of ZGD-1). Both shareholders (pursuant to Article 233 of ZGD-1) and members of management or supervisory bodies (pursuant to Article 263 of ZGD-1) are liable for violating the payment ban. In case of a waiver of the obligation to provide contributions, the debt waiver agreement is null and void pursuant to the first paragraph of Article 86 of the Code of Obligations.\textsuperscript{32}

#### 4.2 Payment ban after the reduction of subscribed capital

The ban stipulated by the first sentence of Article 380 of ZGD-1 enters into force when the simplified subscribed capital reduction becomes effective, i.e. when the resolution on capital reduction is registered in the court registry (third paragraph of Article 379 in relation with Article 374

\textsuperscript{27} Oechsler in Münchener Kommentar (Goette et al., 2011, § 229, l. no. 4), including a presentation of possible occurrence of competition of creditors.

\textsuperscript{28} Cf. Lutter in Kölner Kommentar (Zöllner et al., 1995, § 230, l. no. 21).

\textsuperscript{29} Accord Plavšak in ZGD-1 (Kocbek et al., 2014, p. 440).

\textsuperscript{30} In future periods, the loss covered with the released amount of subscribed capital could otherwise be covered from profit (eleventh paragraph of Article 64 and first paragraph of Article 230 of ZGD-1). Cf. Lutter in Kölner Kommentar (Zöllner et al., 1995, § 230, l. no. 3).

\textsuperscript{31} Cf. Lutter in Kölner Kommentar (Zöllner et al., 1995, § 230, l. no. 3).

of ZGD-1). As of that moment, dividend payments are not admissible, and the company is not allowed to utilize distributable profit for other purposes stipulated by the corporate charter until the amount of statutory reserve-fund reaches the threshold stipulated by law or corporate charter. The share of subscribed capital to be reached by statutory reserve-fund is measured on grounds of the reduced subscribed capital. Until statutory reserve-fund has been filled, the provision of the fourth paragraph of Article 64, which stipulates a 5% restriction of the amount of net profit which may be reallocated to statutory reserves, does not apply (as per the second sentence of Article 380 of ZGD-1). The second sentence of Article 380 of ZGD-1 does not prescribe the obligation to set aside and reallocate statutory reserves, as the latter is still governed by the third and fourth paragraph of Article 64 of ZGD-1. The second sentence of Article 380 of ZGD-1 merely breaks through the 5% threshold stipulated by the fourth paragraph of Article 64 of ZGD-1. The fourth paragraph of Article 64, modified by the second sentence of Article 380 of ZGD-1, thus denotes the following: If necessary, the company shall reallocate to statutory reserves all net profit, reduced by the amount potentially required to cover the carried-forward loss, until statutory reserve-fund reaches the share of (the reduced) subscribed capital stipulated by law or corporate charter. The primary (and, to a certain extent, only) intent and purpose of Article 380 of ZGD-1 is the safeguarding of creditors, including future creditors.33 The institution allows for a quicker renouncement of the payment ban and is thus only of indirect benefit to the shareholders.

The law calls for an accelerated filling of statutory reserves and protection of capital against (potential future) losses, as well as for the strengthening of capital after the simplified subscribed capital reduction becomes effective. The payment ban instituted by categories of tied-up capital is reduced through the reduction of subscribed capital and the covering of losses with assets made available by the capital reduction. If subscribed capital would not be subject to reduction, future profits would need to be utilized to cover the loss, i.e. to fill tied-up assets.34 It is for this very purpose that the law locks up future profits in the company, so that they need to be reallocated (in an accelerated manner) to the tied-up capital category (statutory reserves). By doing so, the law not only ties up the assets prior to the reduction of subscribed capital (second paragraph of Article 379 of ZGD-1) and assets made available by capital reduction (first paragraph of Article 379 of ZGD-1), but also the profits realized after the reduction of subscribed capital (Article 380 of ZGD-1). Dividend payments are not admissible and distributable profit shall not be utilized for other purposes stipulated by the corporate charter. Not only is the company allowed to reallocate a greater volume of net profit to statutory reserves, it is obligated to do so. Until statutory reserve-fund has been filled, distributable profit does not exist, since the entire net profit is channeled to statutory reserves.

4.3 In all cases and instances

The situations referred to in the first indent of the second paragraph of Article 379 and the first sentence of Article 380 of ZGD-1 are related to the same qualifying element: filled statutory reserve-fund, the amount of which is measured on grounds of the new (reduced) amount of subscribed capital. The maximum amount of statutory reserves which may remain in order for simplified subscribed capital reduction to be admissible is equal to the minimum amount which allows a company to freely utilize distributable profit after the capital reduction becomes effective. Regardless of the intent and purpose (first paragraph of Article 379 of ZGD-1) for which simplified subscribed capital reduction was executed, it may occur that the company will have full statutory reserve-fund available for disposal immediately after subscribed capital reduction becomes effective. It may also occur that the company will previously utilize even those tied-up reserves which it might had saved, meaning that statutory reserve-fund will not be full after the capital reduction. The application (effect) of Article 380 of ZGD-1 is thus not dependent on the purpose (first paragraph of Article 379 of ZGD-1) of simplified subscribed capital reduction, but rather on the level of filled capacity of statutory reserve-fund at the moment when capital reduction becomes effective.

5 Too Narrow and Too Broad at the Same Time

To be precise, the previously referred to promotion of capital strength is only part of the truth, as the law simultaneously takes away some of the company’s room for manoeuvre which it could have had without endangering its creditors. If Article 380 of ZGD-1 would not have the second sentence, the reallocation of statutory reserves would be governed only by the fourth paragraph of Article 64 of ZGD-1. Moreover, if the first sentence of Article 380 of ZGD-1 would not extend beyond the ban on payment of distributable profit to shareholders, the surplus net profit, i.e. the profit in excess of 5%, would be channeled to distributable profit, which could in turn be utilized for other purposes (stipulated by law or corporate charter), including

33 In German law, cf. Veil in Schmidt/Lutter AktG (Schmidt et al., 2008, § 233, l. no. 1-2).
34 Cf. Lutter in Kölner Kommentar (Zöllner et al., 1995, § 233, l. no. 3).
the setting aside of statutory reserves (if so stipulated by the corporate charter), whereas the 5% threshold stipulated by the fourth paragraph of Article 64 is (most certainly) not relevant to the aforementioned situation. \[35\] Distributable profit still couldn’t be channeled to shareholders (until statutory reserve-fund has been filled), whereas the decision on accelerated protection and strengthening of capital by means of tied-up reserves would be left to shareholders, i.e. to those who are not entitled to distributable profit until the capital has been given adequate protection and reached adequate strength (as stipulated by law or corporate charter). If distributable profit would be classified as carried-forward profit, the latter would automatically be utilized to cover potential net loss (incurred in future fiscal periods). In case the general meeting decided to utilize distributable profit to set aside other reserves from profit (first sentence of the sixth paragraph of Article 230 of ZGD-1), the latter could (again) be utilized to cover the loss. In case of potential net loss, the carried-forward profit and other reserves from profit would even be the first to suffer. The same is true for corporate charter reserves\[36\] if they are allowed to be utilized to cover the loss. Moreover, shareholders would be given the chance to directly influence subscribed capital even before statutory reserve-fund has been filled (and could do so to a much greater extent): distributable profit may be categorized as carried-forward profit, and the latter is an admissible source of increasing subscribed capital with company assets (fifth point of the first paragraph of Article 359 of ZGD-1).

5.1 Safeguarding of creditors that benefits shareholders

Article 380 of ZGD-1 safeguards the creditors. Until statutory reserve-fund has been filled, the provision does not allow for any derogation and shareholders must simply accept the payment ban (the same applies to other potential beneficiaries of distributable profits, if they are entitled to receive payments pursuant to the corporate charter). However, this is where it all ends. Immediately after statutory reserve-fund has been filled, the full distributable profit may again be distributed among shareholders and utilized for other purposes stipulated by the corporate charter. As a matter of fact, it is now even easier to channel distributable profit from the company, since the threshold of the payment ban, set with categories of tied-up capital, mostly subscribed capital, has been lifted (reduced). The foregoing notwithstanding, the law fails to stipulate any additional safeguards to the filling of statutory reserve-fund, and even the amount of the latter is measured on grounds of the reduced subscribed capital. For clarity purposes and to help future analysis, let us consult the following typical example, referred to in the second paragraph of Article 379 of ZGD-1.

In the example above, the company is able to execute a simplified subscribed capital reduction in order to cover the loss (-250); however, it does not need to execute a prior release of tied-up reserves. After the subscribed capital reduction executed in order to cover the loss, the position is as shown in Table 2.

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**Table 1 Position Prior to the Reduction of Subscribed Capital**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities + Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscribed capital</td>
<td>1,000</td>
</tr>
<tr>
<td>Capital reserves (points 1 through 3 of the first paragraph of Article 64 of ZGD-1)</td>
<td>30</td>
</tr>
<tr>
<td>Statutory reserves</td>
<td>45</td>
</tr>
<tr>
<td>Net profit/loss</td>
<td>-250</td>
</tr>
<tr>
<td>Liabilities</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,025</strong></td>
</tr>
</tbody>
</table>

**Table 2 Position After the Reduction of Subscribed Capital**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities + Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscribed capital</td>
<td>750</td>
</tr>
<tr>
<td>Capital reserves (points 1 through 3 of the first paragraph of Article 64 of ZGD-1)</td>
<td>30</td>
</tr>
<tr>
<td>Statutory reserves</td>
<td>45</td>
</tr>
<tr>
<td>Liabilities</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,025</strong></td>
</tr>
</tbody>
</table>

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\[35\] Unlike the German AktG (third paragraph of § 58), ZGD-1 fails to stipulate that distributable profit may be utilized to set aside reserves from profit, but only limits the utilization of distributable profit to other reserves from profit (Liabilities and Equity A. III. 5.). According to the German AktG, distributable profit may, by law, be utilized to set aside additional statutory reserves. Per ZGD-1, the latter would be possible on grounds of appropriate corporate charter regulation. In the aforementioned instance, the general meeting would be able to decide on the reallocation of distributable profit to statutory reserves. The general meeting is also not obligated to adhere to the 5% threshold stipulated by the fourth paragraph of Article 64 of ZGD-1 when deciding on the amount of distributable profit to be reallocated. This allows for setting aside of statutory reserves prematurely and allows the company to reach the upper limit of the statutory reserve-fund threshold in an accelerated manner. The upper limit of statutory reserve-fund and the 5% allocation threshold are thus relevant only when reallocating statutory reserves from net profit with regard to the preparation and adoption of the annual report. However, the grounds for challenge stipulated by Article 399 of ZGD-1 need to be observed even in case of reallocation of statutory reserves as part of the utilization of distributable profit. For details on setting aside reserves from profit from distributable profit see Dmovidje (2010, p. 1502, 1519-1521).

\[36\] Corporate charter reserves are the reserves referred to in the fourth indent of the second paragraph of Article 64 of ZGD-1 (Liabilities and Equity A. III. 4.).
After the subscribed capital reduction the payment ban is still instituted by tied-up capital categories (as well as foreign capital), however, the very amount of tied-up capital has been reduced (previously 1,075; now 825). In case the company would not cover the loss by executing a simplified subscribed capital reduction, it would first need to utilize future profit to cover the loss and fill statutory reserve-fund. The company would thus need to realize profit in excess of 275 (250 to cover the loss and an additional 25 to fill statutory reserve-fund). However, after covering the loss against subscribed capital, the company does not need to realize any additional profit, but is free to channel the entire new profit to shareholders (among others). Although the loss-affected assets of the company have not been changed (strengthened) with the reduction of subscribed capital, and the position of creditors has subsequently not been altered, it is still possible to channel all future profit away from the company. At this point, one needs to recall the fact that the main replacement for Article 375 of ZGD-1 with regard to simplified subscribed capital reduction is represented by the inadmissibility of channeling released assets to shareholders. However, as shown in the previous example, the situation is not far from what the law prohibits. The relevant amount of subscribed capital may not have been paid to the shareholders, however, the very reduction of subscribed capital allowed the company to cover the loss and simultaneously lower the payment ban, instituted by elements of tied-up capital, and thus achieve easier (quicker) channeling of distributable profit.

6 Consequences of Violations

An annual report violating Article 380 of ZGD-1 is null and void (first indent of the first paragraph of Article 401 of ZGD-1), as is a general meeting resolution on the utilization of distributable profit (third indent of Article 390 of ZGD-1). Both shareholders (pursuant to Article 233 of ZGD-1) and members of management and supervisory bodies (Article 263 of ZGD-1) are liable for violations of the payment ban.

7 Conclusion

The foregoing analysis leads us to the following valid conclusion: the concept of safeguarding of creditors as referred to in Article 380 of ZGD-1 allows for a (completely legal) circumvention of rules governing the terms for admissibility of simplified subscribed capital reduction (Article 379 of ZGD-1). The amounts referred to in Article 379 of ZGD-1 are, in fact, utilized solely for recovery, however, this very command is undermined by the (next available) option to channel (excessive) profits away from the company after the reduction of subscribed capital.37 This gap is quite simple to bridge: the existing concept of safeguarding of creditors should be supplemented by introducing a time-limited ban on the payment of the majority of distributable profits, which would apply despite the fact that the statutory reserve-fund has been filled. Such a ban would give a company sufficient room for manoeuvre in strengthening its financial position in the future. A quantity-based parallel could be drawn by reference to Article 399 of ZGD-1 which stipulates that a 4% dividend is considered sufficient margin for the safeguarding of shareholders’ interests.38 Article 380 of ZGD-1 thus needs to be amended so that a certain period of time (e.g., two fiscal years after the general meeting resolution) needs to pass before the majority of distributable profits (e.g., dividend in excess of 4%) can be paid, even though the statutory reserve-fund had been filled. An exception to the rule may be justified only by the safeguarding of creditors, modelled after the safeguarding regime applied in ordinary subscribed capital reduction.39

37 German law (§ 233 of the German AktG) therefore justifiably limits the amount of distributable profit payments for a full two years after the adoption of the resolution on simplified subscribed capital reduction even if statutory and capital reserves have been sufficiently filled. Legal theory emphasizes that this very restriction replaces the concept of safeguarding of creditors, which is applied to ordinary subscribed capital reduction. For details, see Oechsler in Münchener Kommentar (Goette et al., 2011, § 233, l. no. 2-3). Cf. Lutter in Kölner Kommentar (Zöllner et al., 1995, § 233, l. no. 3).

38 First paragraph of Article 399 of ZGD-1: a general meeting’s resolution on the appropriation of distributable profits may be challenged . . . if the general meeting decides not to distribute the profits to the shareholders in the amount corresponding to at least 4% of the share capital, provided that, according to the due diligence principle, this is unnecessary given the circumstances in which the company operates.”

39 In comparative law, such a solution is referred to in the second paragraph of § 233 of the German AktG: “[… ] Die Zahlung eines Gewinnanteils von mehr als vier vom Hundert ist erst für ein Geschäftsjahr zulässig, das später als zwei Jahre nach der Beschlußfassung über die Kapitalherabsetzung beginnt. Dies gilt nicht, wenn die Gläubiger, deren Forderungen vor der Bekanntmachung der Eintragung des Beschlusses begründet worden waren, befriedigt oder sichergestellt sind, soweit sie sich binnen sechs Monaten nach der Bekanntmachung des Jahresabschlusses, auf Grund dessen die Gewinnverteilung beschlossen ist, zu diesem Zweck gemeldet haben. […]”.

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Varstvo upnikov pri poenostavljenem zmanjšanju osnovnega kapitala

Izvleček
Osrednji značilnosti poenostavljenega zmanjšanja osnovnega kapitala sta zelo osebn namen in oslabljeno varstvo upnikov. Namen je pravzaprav le en, namreč sanacija. Od finančno prizadete družbe je težko pričakovati, da bo pri zmanjšanju osnovnega kapitala, ki je namenjeno sanaciji, sposobna varovati upnike po merilih, ki veljajo pri rednem zmanjšanju osnovnega kapitala. V prispevku avtor analizira namen poenostavljenega zmanjšanja osnovnega kapitala in zakonsko ureditev varstva upnikov. Pri tem z metodo deskripcije, vsebinsko analizo in primerjalno študijo utemelji, zakaj je pravna ureditev varstva upnikov prešibka glede na učinke te oblike zmanjšanja osnovnega kapitala, in predlaga spremembo zakonske ureditve.

Ključne besede: poenostavljeno zmanjšanje osnovnega kapitala, varstvo upnikov, podbilanciranost, izplačilna prepoved, vezanost premoženja