FACULTY OF LAW AND CRIMINOLOGY

# Financial Law Institute

## Working Paper Series

WP 2019-08

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# Regulating distributions to shareholders through balance sheet and solvency tests: The Belgian and Dutch example

GHENT UNIVERSITY

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# REGULATING DISTRIBUTIONS TO SHAREHOLDERS THROUGH BALANCE SHEET AND SOLVENCY TESTS: THE BELGIAN AND DUTCH EXAMPLE

In this paper, we intend to explore the optimal design of rules on distributions to shareholders. To this end, we commence by examining why and in what scenarios rules on shareholder distributions might be useful from a creditor protection perspective. Against this backdrop, we proceed by assessing the traditional continental approach and its net assets and retained earnings test. More specifically, we map out the benefits and drawbacks of the continental approach. Subsequently, we examine how the Dutch legislator has aimed to mitigate the downfalls of the traditional continental European approach by fundamentally altering its approach to shareholder distributions in closed companies. In a very similar way, we analyze the recent proposal from the Belgian legislator to amend the rules on distributions to shareholders. Finally, we assess to what extent the Dutch and Belgian approaches come close to an optimal regime for distributions to shareholders in closed companies.



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The final version of this paper has been published in D. Bruloot (ed.), *Belgian and European perspectives on creditor protection in closed companies*, Antwerp, Intersentia, 2019, 69-101.

The entire working paper series can be consulted at http://www.law.ugent.be/fli/.

## 1 Introduction

In this paper, we intend to explore the optimal design of rules on distributions to shareholders. To this end, we commence by examining why and in what scenarios rules on shareholder distributions might be useful from a creditor protection perspective. Against this backdrop, we proceed by assessing the traditional continental approach and its net assets and retained earnings test. More specifically, we map out the benefits and drawbacks of the continental approach. Subsequently, we examine how the Dutch legislator has aimed to mitigate the downfalls of the traditional continental European approach by fundamentally altering its approach to shareholder distributions in closed companies. In a very similar way, we analyze the recent proposal from the Belgian legislator to amend the rules on distributions to shareholders. Finally, we assess to what extent the Dutch and Belgian approaches come close to an optimal regime for distributions to shareholders in closed companies.

## 2 The necessity of rules on distributions to shareholders

### 2.1 Company law and rules on creditor protection in general

Over the last fifty years, the predominant view in continental Europe has been that company law should play an important role in the protection of limited liability companies' creditors. In most EU member states, the legal framework is in line with this paradigm. More specifically, based on the model advanced in the Second Company Law Directive (Second CLD),[1] most member states have opted for a comprehensive framework construed around the concept of "legal capital". This model consists of a long list of rules on capital formation and maintenance, which all (at least partially) envision the protection of companies' creditors.[2] Although the Second CLD does not apply to private



[1] Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, *OJ L* 26, 31 January 1977, p. 1, hereinafter referred to as ***"Second CLD"***. In 2012, this directive has been repealed and replaced by a new directive 2012/30/EU without, however, bringing any material changes to the directive's text, see Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, *OJ L* 315, 14 November 2012, p. 74. Finally, in 2017, all European directives in the area of company law have been reorganised into one single legislative document being Directive 2017/1132/EU of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, *OJ L* 169, 30 June 2017, p. 46, hereinafter referred to as ***"Company Law Directive"***. The rules on legal capital are incorporated in articles 44 to 86 of this Company Law Directive.

[2] Besides the creditor protection objective, these rules also serve other functions (predominantly the division of shareholders' voting and profit rights).

companies[3] (*i.e.* "closed companies", according to the continental terminology), most member states have implemented the rules for these companies in some way as well.[4]

However, more recent insights rebut the traditional continental notion that company law is vital for the protection of companies' creditors.[5] According to this modern paradigm, the legislator should only intervene in a limited number of cases with rules of company law to protect creditors. Such approach thus refutes the traditional continental idea of a complete framework for creditor protection within company law. The situations in which legislative intervention is still warranted are the scenarios in which the interests of creditors are clearly unaligned, or even conflicting, with the interests of shareholders (and their agents). Four situations, outlined beneath, are identified in this respect. In all other scenarios, directors presumably act in the interest of the shareholders (*i.e.* directors pursuing profit maximization) and are thus automatically acting in the best interest of creditors too, as the main interest of the latter lies in being repaid on time.

**(1)** The first situation that needs the legislator's attention, but stays completely out of the scope of this article, is a company's *restructuring*. Creditor rights can especially be endangered in the case of mergers and divisions, which are necessarily regulated by company law. That is to say, these transactions fundamentally alter the composition of the pool of assets out of which creditors must be repaid. Company law rules protecting (non-adjusting) creditors can therefore be seen as a necessary feature of rules on restructurings.[6]



**(2)** The second situation in which legislators are supposed to impose rules on a company's insiders to protect creditors is when a company nears *insolvency*. In this 'twilight zone', shareholders will incentivize their directors to gamble for resurrection.[7] As shareholders' liability is limited, creditors will bear the risk of such 'gambling behavior'. While there seems to be no discussion on the necessity to address this situation with proper legislative action,[8] there is no wide consensus on whether this issue should be addressed through rules of company or insolvency law.

**(3)** The third situation in which the legislator might reasonably be expected to intervene with creditor protecting company laws, concerns the moment of a company's *formation*. Traditionally,

[3] See article 44 Company Law Directive (former article 1 Second CLD).

[4] Be it often in a more limited way. In certain member states this light version of the capital regime for private companies was adopted from the onset (in the UK for instance), while other member states only did so through an amendment in the last two decades (*e.g.* the 2003 "Loi Dutreil" in France (Loi n° 2003-721 du 1 août 2003 pour l'initiative économique, *Journal officiel* 6 août 2003) or the 2008 "MoMiG" in Germany (Gesetz vom 23 Oktober 2008 zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen, *BGBl.* 28. Oktober 2008, Teil I, Nr. 48, 2026)).

[5] The more recent insights, which are predominantly defended in legal literature, but are being picked up increasingly by national legislators as well, are heavily inspired by the experiences in Anglo-Saxon jurisdictions, which clearly have a different tradition in this respect. See for instance Armour et al. 2017, p. 110-143; Davies 2006, p.303-305. Armour et al. advance a more contractual perspective on creditor protection. A comprehensive and critical overview of the contractual and economic perspective on creditor protection can also be found with *e.g.* Keay 2003, p. 665-699.

[6] See for instance with regard to mergers article 99 Company Law Directive.

[7] Couwenberg and Lubben 2013, p. 72; Davies 2006, p. 304; Eidenmuller 2006, p. 240; Kuhner 2006, p. 350.

[8] Armour et al. 2017, p. 114; Davies 2006, p. 306; Kaey 2005, p. 433; Mokal 2000, p. 342; Prenctice 1990, p. 265. Differently: Hu and Westbrook 2007, p. 1321-1403. See in this respect also Couwenberg and Lubben 2013, p. 61-76.

the continental European approach addresses this issue - rather unsuccessfully - through minimum capital requirements. However, some authors doubt the necessity of rules addressing creditors' interests at the time of a company's formation.[9] According to a – in our view preferable - contemporary and more nuanced view, this type of rules should focus on the risk inflicted by companies that are deemed to go bankrupt from the onset and the issue of transparency with regard to the identity of the company's founders.

**(4)** The fourth and final situation in which legislative intervention is desirable is the one that is central to this contribution and concerns companies making *distributions* to their shareholders. Through these distributions, assets are leaving the company in favor of the shareholders without any compensation, which is of course detrimental to the creditors. As distributions directly reduce the pool of assets out of which creditors must be repaid, there is almost no discussion on the need of having company law rules limiting distributions to shareholders.[10]

### 2.2 Company law and distributions to shareholders

Rules on distributions to shareholders aim to prevent that a company can make distributions that leave the company without sufficient assets to continue its activities and to pay its debts as they fall due. When designing such rules, it should however be borne in mind that making profit distributions to shareholders is one of the fundamental aspects of corporate life. The rules on distributions must thus strike a balance between the interests of shareholders and the interests of creditors. Two basic ideas seem to be useful in this respect.



First, one should only allow distributions to the extent they result from a surplus. Such surplus generally equals the profits generated by a given company. Distributions not originating out of a surplus are executed entirely at the risk of the creditors. Such risk shifting cannot be accepted if one assumes that the shareholders must ultimately bear the risk within a company.

Secondly, besides the aforementioned (rather theoretical) concern, a more practical factor should be considered when designing rules on shareholder distributions. More precisely, distributions should not lead to the company's inability to conduct its activities on a going concern basis, as in that case the distributions have been made at the expense of the creditors. In this respect, one must answer the delicate question about the relevant timeframe to consider in the assessment of the viability of the distributions. Obviously, the distribution should not immediately lead to the bankruptcy of the company. However, distributions should also not compromise the company's future solvency. In terms of regulatory design, difficulties arise with regard to the impact assessment of distributions on future solvency.

[9] *Cf.* Davies 2006, p. 310.

[10] The only argument against such rules is that they are superfluous as creditors can insert dividend limitations into their credit contracts too (so called dividend covenants; see e.g. Bratton 2006, p. 54-55). However, this reasoning overlooks that many closed companies have no real adjusting creditors (as they have no (large amount) loans). Consequently, these companies are left without any limitation regarding distributions to shareholders. This is to the detriment of both creditors and directors of these companies.

Besides the importance of the balance between shareholder and creditor interests, it is furthermore crucial to complement the rules on dividends by rules on indirect distributions. The most important examples in this respect in the traditional European model are share buy-backs and capital reductions. These transactions do equally result in an asset transfer from the company to its shareholders for which the company is not compensated.[11] From that perspective, it is rather obvious that these transactions should be subjected to limitations that are similar to the ones on regular distributions. However, one should always take into account the specificities of the distribution at stake. Another, more disputed, example of indirect distributions concerns financial assistance transactions as described in the Second CLD.[12] Furthermore, the rules on distributions are traditionally thought to apply in some way to disguised distributions as well. Disguised distributions are transactions that do not formally qualify as distributions, but do have the same effect (*e.g.* transactions with shareholders that are not at arm's length).

Lawmakers have to tackle different issues when regulating distributions to shareholders. First, policymakers should address the design of the limitation as such (a). Secondly, the perimeter of the relevant law must determine to whom the rules will be addressed (b). Thirdly, lawmakers should determine the consequences of unlawful distributions (c). Finally, the scope of the limitation (*i.e.* to which transactions it must be applied) must be clear (d). We will assess these four elements in our analysis of the different regulatory regimes on distributions to shareholders.



## 3 The traditional continental approach: net assets and/or retained earnings test

### 3.1 The central idea

The leading European approach with regard to distributions to shareholders dates back to the Second CLD from 1976. Although, in principle, the member states only have to apply the approach from the directive to public (or open) companies,[13] most national legislators have decided to adopt identical or similar rules for private companies *(cf. supra)*.

All rules of the directive are built around the concept of "legal capital". This is no different for the rules on distributions to shareholders. It follows that the directive and the transposing national legislation mainly aim to achieve the objectives of the rules on distributions (as set out under title 2) through rules based on the legal capital concept. That is to say, distributions can only be made to the extent that a surplus of assets over liabilities exceeding the amount of the company's legal capital is present. The reverse equally is true. As long as a distribution does not jeopardize the capital buffer, the distribution is assumed to not lead to a company's insolvency.

[11] With regard to share buybacks, the asset transfer without compensation is at least present when the shares are immediately annulled.

[12] Article 64 Company Law Directive (former article 23 Second CLD).

[13] Article 44 Company Law Directive (former article 1 Second CLD).

The traditional continental approach is well reflected in the text of the Second CLD. More specifically, the Second CLD places two limits on distributions to shareholders: a net assets test and a retained earnings test. According to the net assets test: "*[N]o distribution to shareholders may be made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes.*"[14] The retained earnings test (also known as the enhanced profits test), on the other hand, prescribes the following: "*The amount of a distribution to shareholders may not exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes.*"[15] In essence, both tests lead to the same result.[16] For that reason, different member states only implemented one of the two rules (*i.e.* the net assets test) into their national laws (see *e.g.* Belgium and the Netherlands). However, most of the member states implemented both (see *e.g.* France).

### 3.2 Advantages

The traditional continental approach to limiting distributions to shareholders results in two important benefits.



First, this approach to limitations on distributions to shareholders corresponds with the traditional idea about the meaning of distributions to shareholders. That is to say, distributions to shareholders are traditionally perceived to be wealth transfers from a company towards its shareholders stemming from the surplus generated by that company's operations. The traditional continental approach to distributions to shareholders thus takes the perspective that is the closest to the (historic) understanding of the concept of (profit) distribution.

A second advantage of the Second CLD's net assets test is that – at least at first sight – it serves as a bright line rule, which is easy to apply and easy to control. However, in the next paragraph, we will nuance this alleged benefit of the traditional continental approach.

### 3.3 Drawbacks

The way in which distributions are limited according to the Second CLD suffers from some important shortcomings as well. Consequently, these drawbacks are also present in the current Belgian approach to public and private companies[17] and the current Dutch approach to public companies[18].

[14] Article 56 (1) Company Law Directive (former article 15 (1) (a) Second CLD).

[15] Article 56 (3) Company Law Directive (former article 15 (1) (c) Second CLD).

[16] However, under certain circumstances, national accounting law may lead to different outcomes of respectively the net assets and the retained earnings tests. More precisely, if the notion "reserves" only includes the own funds arising from profits generated by the company, the enhanced profits test will be considerably stricter than the net asset test. This follows from the fact that in that case share premiums *inter alia* increase the distribution capacity under the net assets test, whereas these share premiums are non-distributable under the enhanced profit test. See for instance Mülbert and Birke 2002, p. 704 and 720.

[17] Articles 617-619 (public companies) and 320 (private companies) Belgian Company Code.

3.3.1 General shortcomings

First, the approach from the Second CLD to distributions to shareholders completely neglects the "liquidity" parameter. This is hard to justify, as it particularly is the ability of a company to pay its debts as they fall due which is of the greatest importance to creditors. The fact that the Second CLD does not acknowledge its significance is a major shortcoming of the current European rules, which renders these rules ineffective from a creditor protection perspective.[19] Whether a debtor, according to its balance sheet, maintains a surplus of assets over liabilities posterior to a distribution, is of little importance to creditors if the debtor is unable to pay his debts as they fall due. Even if the surplus exceeds the amount of legal capital, the same consideration applies. Some European member states have tried to manage this deficiency, particularly in recent years, by establishing rules that impel directors to observe an additional margin of prudence. Such augmented margin of prudence is either designed through mandatory rules[20] or modelled in jurisprudence through directors' general duty of care[21].

Secondly, the distribution rules of the Second CLD are also problematic because the results of a net assets test do not necessarily reflect the most recent state of affairs. This follows from the fact that the rules are being applied to figures stemming from a balance sheet reflecting the company's financial situation of – at least - a few months earlier. The test thus fails to take into account the most recent developments. For instance, profits present on the balance sheet of the closing date of the last accounting year, might be neutralised already by losses at the time a company decides to pay out dividends. Moreover, the same holds true for negative outlooks, as these in no way have to be considered when applying the net assets- or retained earnings test.[22]



Thirdly, another problem concerning the rules on profit distributions from the Second CLD follows from the strict link between the distribution rules and the company's balance sheet. Inconsistencies or evolutions within the accounting rules produce a direct impact on profit distributions, which is odd, as the underlying economic situation of the company remains unaltered. The international switch to IFRS is an important example of this phenomenon. As is well-established, the traditional accounting rules of the Fourth (and Seventh) Company Law Directive are supposed to support the distribution rules of the Second CLD. This especially occurs through the promotion of the principle of prudence and, in line with that principle, historic cost accounting as main valuation method. However, this supportive function of the accounting rules disappears if a balance sheet is drawn up according to the international accounting standards. That is to say, these standards are inspired by another, more investor-oriented, accounting view. Most member states that do allow the use of figures stemming from an IFRS-balance sheet in the net assets test, have adopted specific rules to

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[18] Article 2:105 Dutch Civil Code.

[19] Willermain (2011), p. 269; Mähönen (2008), p. 129; Heaton 2007, p. 999; Rickford (2006), p. 177.

[20] See in this respect for instance chapter 13 – section 2 of the Finnish Companies Act: *"Assets shall not be distributed, if it is known or should be known at the time of the distribution decision that the company is insolvent or that the distribution will cause the insolvency of the company"*.

[21] Like is the case in Belgium or the Netherlands, see infra titles 4 and 5.

[22] Bruloot 2014, p. 595.

neutralise the most important issue in this regard, which is the fact that non-realised profits resulting from fair value accounting are actually distributable. This is *inter alia* the case in the UK, Italy, the Netherlands, Denmark, Ireland and Malta.[23]

3.3.2 Why the Second CLD's net assets test is not a bright line rule

The traditional continental European approach to profit distributions is not as straightforward as it might appear at first sight (see *supra* 3.2). More concretely, the wide range of nuances and modifications at the European and national level frustrate the operational advantage of a conceptually bright line rule. In what follows, we first discuss the obstacles on the European level in this respect. Subsequently, we focus on the hurdles stemming from disparities in national law.

At the European level, the Second CLD states that the net assets should in principle be measured against the amount of subscribed capital.[24] However, this rule only applies to the extent that the uncalled part of the subscribed capital is included in the assets shown in the balance sheet. If this is not the case (*e.g*. under Belgian law),[25] the uncalled part of the capital has to be deducted from the amount of subscribed capital.[26] Furthermore, in this context, one should consider article 12 (11) of the Accounting Directive,[27] which deals *inter alia* with costs of development and formation expenses. To the extent that member states allow costs of development and formation expenses to be included in the balance sheet as assets, the aforementioned article states that no distribution of profits may take place, unless the amount of the reserves available for distribution and profits brought forward is at least equal to that of the costs not written off.



Another important issue in this respect follows from the introduction of the IAS/IFRS accounting standards in the European legal order by the IAS Regulation.[28] Although the situations in which the IAS/IFRS standards must mandatorily be applied are rather limited (*i.e.* solely consolidated accounts of publicly traded companies),[29] the IAS Regulation allows member states to extend the application of the IAS/IFRS standards to all annual accounts.[30] On top of that, member states are free to decide whether they require companies to comply with such extension or merely permit companies to employ the IAS/IFRS standards. The leeway enjoyed by the member states under the IAS Regulation has resulted in a complex interplay of reporting standards of different origins in different member states.[31] For our purposes, this is highly relevant, as the Second CLD's net assets and enhanced

[23] See for a further overview in this respect KPMG 2008, p. 320-322.
[24] Article 56 (1) Company Law Directive (former article 15 (1) (a) Second CLD).
[25] See article 617 (1) Belgian Company Code.
[26] Article 56 (2) Company Law Directive (former article 15 (1) (b) Second CLD).
[27] Article 12 (11) Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, *OJ L* 182, 29 June 2013, p. 19, hereinafter referred to as the ***"Accounting Directive"***.
[28] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, *OJ L* 243, 11 September 2002, p. 1, hereinafter referred to as the ***"IAS Regulation"***.
[29] See article 4 IAS Regulation.
[30] Article 5 IAS Regulation.
[31] Bruloot 2014, p. 166-167.

profits test results will differ depending on whether one applies them to financial statements prepared in accordance with the classical principles of the Accounting Directive or in accordance with the IAS/IFRS standards.[32] Hence, the possibility to distribute to the shareholders will equally depend on the type of accounting rules at hand. The modernization of the European accounting system has rendered this issue even more critical.[33] Although the modernization has introduced certain concepts of the IAS/IFRS standards into the European legal framework, the European legislator refused to introduce a European solution for the issues this causes and thus leaves it up to the member states to develop a so-called IFRS add-on to the net assets test.[34]

3.3.3 Why the net assets test as implemented in the member states is not a bright line rule

Besides nuances at the European level, efforts undertaken by national legislators to cope with the drawbacks of the net assets test also muddle the straightforward character of the rule. For instance, certain member states, like Finland and Sweden, have adjusted the existing restrictions on distributions to shareholders within the (limited) scope left by the Second CLD.[35] More specifically, these countries have supplemented the rule from the Second CLD by some sort of solvency test. In Finland, for example, assets should not be distributed "*if it is known or should be known at the time of the distribution decision that the company is insolvent or that the distribution will cause the insolvency of the company*".[36]



In the Netherlands, not the legislator but the jurisprudence presented a solution for the major flaw of the traditional net assets test. In the famous *Nimox* case, the Dutch Supreme Court determined that the mere compliance with the national laws implementing the limits on distributions as articulated in article 17 of the Second CLD does not protect shareholders and directors against liability claims by third parties.[37] After all, if shareholders or directors made (*Nimox* judgment) or executed (*Reinders Didam* judgment)[38] a decision to distribute, and the actual distribution results in the reasonably foreseeable effect that the creditor claims can no longer be satisfied, they have committed an unlawful act, for which they can be held liable to third parties.

Furthermore, the introduction of the IAS/IFRS standards (see *supra*) in certain national legal frameworks has significantly contributed to a more complex and diffuse pallet of national rules,

[32] Bruloot 2014, p. 169; Szafran 2006, p. 398; Beckman 2003, p. 15.

[33] Bruloot 2014, p. 179-182.

[34] See Position of DG Internal Market and Services concerning the results of the external study on the feasibility of an alternative to the Capital Maintenance Regime of the Second Company Law Directive and the impact of the adoption of IFRS on profit distribution, p. 2.

[35] Bruloot 2014, p. 637.

[36] Chapter 13 – section 2 Finnish Companies Act.

[37] Dutch Supreme Court 8 November 1991, Nederlandse Jurisprudentie 1992, 174 (case note Ma). This decision was confirmed in the *Reinders Didam* case: Dutch Supreme Court 6 February 2004, Jurisprudentie Onderneming & Recht 2004, 67. See on this case law *inter alia* De Kluiver 2006, p. 64; Bier 2003, p. 55-57; Lennarts 1999, p. 225.

[38] Dutch Supreme Court 6 February 2004, Jurisprudentie Onderneming & Recht 2004, 67.

which muddles the bright line rule from the traditional European approach. In this context, reference can particularly be made to the Italian and British approach.[39]

Discussions within member states on the interpretation of certain concepts or rules can serve as a last example of the fact that the rules on profit distributions from the Second CLD do in reality not constitute a bright line rule. In Belgium, for instance, legal scholarship does not agree on what figures to use when applying the net assets test to decisions that have not been taken during the annual meeting and that pertain to the distribution of dividends.[40] On this point, the Second CLD and the relevant Belgian law[41] both refer to the net assets at "*the closing date of the last financial year*", as set out in the company's annual accounts. Different strands in literature can be distinguished with regard to the interpretation of this condition. First, certain authors posit that only the (last) annual accounts approved by the general meeting can be used.[42] This interpretation is well aligned with the text of the directive. Indeed, as long as the relevant documents are not approved, they are no annual accounts but merely drafts. Another strand in Belgian scholarship contends however that, with regard to a profit distribution in the period between the end of the financial year and the approval of the annual accounts, the net assets test must be applied to an accounting statement reflecting the situation on the date of the closure of the last financial year or to the draft annual accounts for that financial year.[43] Others even conclude that, given the uncertainty, no distributions may be made during the timeframe between the closing of an accounting year and the approval of that year's financial accounts.[44] For our purposes, the most important fact is that this Belgian discussion can be essentially traced back to a more fundamental problem with regard to the net assets test. More precisely, the outdated character of the annual accounts that determine a company's possibilities to distribute might be at odds with the actual present economic reality.



### 3.4 Pros and cons of the other crucial aspects of distribution rules

In the analysis above, we assessed the design of limitations on distributions to shareholders as such. In what follows, we turn out attention to the other questions that must be addressed when developing rules on distributions to shareholders (see (b) to (d) under title 2.2). It concerns the rules' addressees (b); the consequences of unlawful distributions (c); and the scope of the limitation (*i.e.* to which transactions it must be applied) (d). We highlight the traditional continental approach derived

[39] See with regard to Italian law: article 6 (1) a Decreto Legislativo 28 febbraio 2005, Esercizio delle opzioni previste dall'articolo 5 del regolamento (CE) n. 160/2002 in materia di principi contabili internazionali, Gazetta Ufficiale 21 maart 2005. See for an extensive analysis Colombo 2007, p. 553-570. See also Melis et al. 2006, p. 127-138. With regard to the UK, see article 830 (2) Companies Act 2006. See more in detail on this provision Davies 2008, p. 288.

[40] The dividends resulting from such decision dividends should be distinguished from regular interim dividends, which fall under the exclusive competence of the board of directors. See in this respect article 618 of the Belgian Company Code, which implements article 56 (5) of the Company Law Directive (former article 15 (2) Second CLD).

[41] See article 617 of the Belgian Company Code.

[42] Wauters and Bogaerts 2010, p. 76; Tas 2003, p. 516; Wauters 2000, p. 73.

[43] Willermain 2011, p. 279; Colaert 2006, no. 44; De Wulf 2005, p. 397; Simont and Foriers 2004, p. 607.

[44] See Belgian Accounting Standards Committee (CBN) Advice 133-5 – Interimdividend versus tussentijds dividend, 14 January 2009, available via www.cnc-cbn.be. See for a critical appraisal of this advice *inter alia* Willermain 2011, p. 278; Wauters and Bogaerts 2010, p. 78; Wauters 2009, p. 1-3.

from the Second CLD in this respect, together with its Belgian implementation for public and private companies.

First, the perimeter of the relevant legal framework must determine to whom the rules will be addressed. In general, the general meeting makes the final decision regarding dividends. This power is regarded as an appendix to the approval of the annual accounts. However, directors also bear certain duties in this respect. More specifically, directors will in practice propose the actual amount of the distribution. Furthermore, they will be responsible for the payment of the distributions. In most member states, however, this role of the directors is not expressly stated in statutory law and follows from the general division of powers within companies. The lack of express duties for directors regarding dividends is the main reason why directors falsely perceive the net assets test as a safe harbor. The Dutch Supreme Court jurisprudence mentioned above (see *supra* 3.3.3) clearly illustrates that this is not the fact at all. Scarce Belgian jurisprudence in this respect confirms this view as well.[45] Besides the ineffectiveness of the net assets test's substantive criterion (see *supra* 3.3.1), this is one of the major drawbacks of the traditional continental approach of distributions to shareholders. It will therefore not come as a surprise that, more recently, many legislators have tried to cope with this issue.[46]

Secondly, lawmakers should determine the consequences of unlawful distributions. In that respect, the Second CLD stipulates that shareholders must return any distribution made in violation of article 15 if the company proves that these shareholders knew of the irregularity or could, in view of the circumstances, not have been unaware of it.[47] In other words, solely shareholders acting in bad faith must repay unlawful dividends to the company. In all cases where shareholders act in good faith, the only remedy creditors can apply concerns directors' liability for the breach of company law or negligence. Other grounds to reclaim unlawful dividends from shareholders, like the rules on fraudulent transfers in the vicinity of insolvency,[48] prove to be hard to invoke, at least in a Belgian setting.

Lastly, the scope of the limitation (*i.e.* to which transactions it should be applied) must be clear. To that extent, the Second CLD indicates that the rules on distributions must be applied to "*dividends and interest relating to shares*".[49] Furthermore, the directive makes the rules explicitly applicable to share repurchases and financial assistance transactions.[50] However, capital reductions are subject to another set of rules.[51] Finally, the approach towards disguised distributions differs in each member



[45] Court of Appeal of Ghent 11 April 2005, Tijdschrift voor Rechtspersoon en Vennootschap, p. 311 (with casenote by Bogaerts S).

[46] See *supra* footnotes 20 and accompanying text with regard to the Finnish approach and *infra* 4.4 and 5.4 with regard to respectively the Dutch and Belgian approach.

[47] Article 56 Company Law Directive (former article article 16 Second CLD).

[48] Articles XX.112-114 Belgian Code of Economic Law.

[49] Article 56 (4) Company Law Directive (former article 15 (1) (d) Second CLD).

[50] See respectively articles 60 (1) (b) and 64 (6) Company Law Directive (former articles 19 (1) (c) and 23 (2) Second CLD).

[51] Articles 73 *et seq*. Company Law Directive (former articles 30 *et seq*. Second CLD).

state. Belgian literature for instance recognizes the concept, but it does not seem to be applied in practice.[52]

## 4 The 2012 Dutch approach: The Flex-BV

### 4.1 Introduction

The Dutch legislator fundamentally altered the laws applicable to closed companies ("*besloten vennootschap"* or "*BV*") in 2012.[53] Nevertheless, the revision process did already start in 2003.[54] The date of commencement reveals a direct link between the Dutch review process and the EU regulatory competition in the field of company law, which was initiated by some features of the UK "Limited" and the European Court of Justice's case law on the freedom of establishment.[55] At the very least, it is clear that the overall objective of the Dutch reform strongly focused on fostering flexibility within closed company law.

In general, the Dutch legislator has removed the minimum capital requirement of 18.000 euro which was applicable for many years. Nonetheless, the Dutch upheld the concept of legal capital. It should, however, be noted that the rules on capital formation and maintenance were drastically slimmed down: most rules on capital formation [56] and financial assistance were abolished. In light of the foregoing, it is somewhat puzzling that the Dutch legislator preserved a system of shares with par value, thereby maintaining a link between the shares and the capital notion.[57] Within the pool of highly progressive Dutch measures, there is one other element of conservatism that can be mentioned here. More specifically, a notarial deed is still required under Dutch law for the formation of a company, for every issuance of new shares and even for every share transfer.



### 4.2 General characteristics of the rules on distributions

Under new Dutch company law, distributions to shareholders in the BV are governed by a double test.[58] The Dutch legislator requires companies to conduct a balance sheet test and a liquidity test (the latter test is also known as the solvency or distribution test). To conduct these tests, the

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[52] See in this respect *e.g.* Tas (2003: 2), p. 159.

[53] See Wet van 18 juni 2012 tot wijziging van Boek 2 van het Burgerlijk Wetboek in verband met de aanpassing van de regeling voor besloten vennootschappen met beperkte aansprakelijkheid, *Staatsblad* 2012, 299 and Wet van 18 juni 2012 tot aanpassing van de wetgeving aan en invoering van de Wet vereenvoudiging en flexibilisering bv-recht, *Staatsblad* 2012, 300.

[54] De Kluiver H J *et al*., Rapport van de expertgroep ingesteld door de Minister van Justitie en de Staatssecretaris van Economische Zaken: Documenten en publicaties Vereenvoudiging en flexibilisering van het Nederlandse BV-recht, 6 May 2004.

[55] See in particular Case C-208/00, *Überseering BV* v. *Nordic Construction Company Baumanagement GmbH (NCC)*, EU:C:2002:632; Case C-212/97, *Centros Ltd* v. *Erhvervs- og Selskabsstyrelsen*, EU:C:1999:126. See also Maresceau 2014, p. 180 *et seq*.

[56] For instance, the requirement to obtain an expert valuation for every contribution in kind was eliminated.

[57] It is, however, no longer required to base the division of shareholders' rights on each shareholder's stake in the company's legal capital.

[58] Article 2:216 Dutch Civil Code.

concept of legal capital is irrelevant. In the remainder of this paragraph, we outline the most important elements of these two tests.

According to the Dutch **balance sheet test**, the general meeting may only decide to distribute to the shareholders as far as the company's equity exceeds the reserves that must be maintained by virtue of the law or the articles of association.[59] Importantly, legal capital is not considered as a non-distributable reserve for the application of this rule.[60] Moreover, a company is not required to apply the balance sheet test if it does not have any non-distributable reserves. In such scenario, a company can thus limit itself to the liquidity test *(infra)*. This means that, in these cases, under the Dutch balance sheet test, a company might be allowed to distribute irrespective of the state of its equity. Distributions might thus be possible even if the company's liabilities exceed its assets, or in total absence of profits. According to some commentators, "future profit capacity" is being distributed to the shareholders in those cases.

The second leg of the Dutch distribution rules consists of a **liquidity or solvency test**. Dutch legal scholarship tends to refer to this test as the distribution test. The Dutch legislator was clearly inspired by the Model Business Corporation Act (MBCA) when designing the liquidity test.[61] According to the Dutch liquidity test, no distribution may be made if the board of directors is aware or should reasonably foresee that, posterior to the distribution, the company will no longer be able to pay its debts as they fall due.[62] According to the preparatory works, companies must in this respect observe a timeframe that covers at least the next twelve months.[63] However, factors that are already known to the company must equally be considered, even if they pertain to the more distant future. As a rule of thumb, the preparatory works refer to the quick ratio[64] as a first indication for the outcome of this test.[65] At the same time, however, the preparatory works clarify that the test may not be limited to the information present in the balance sheet.[66]



Technically, Dutch law does not impose any obligation to **document** the decision resulting from the double test.[67] Moreover, the law in the Netherlands does – contrary to the Company Law Directive – not refer to the obligatory use of the last approved **annual accountants** for any of the tests. This means that more recent figures (produced by the directors) can be used. Therefore, in this respect no hurdles apply to the distribution of profits from the running accounting year.

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[59] Article 2:216 (1) Dutch Civil Code.

[60] See for instance Groenland 2012, p. 19. Note however that the articles of association of a company can qualify their share capital as a non-distributable reserve; see for a case in that respect *e.g.* Rb. Gelderland (kort geding) 17 February 2014, Rechtspraak.nl, ECLI:NL:RBGEL:2014:1976.

[61] See § 6.40 (c) MBCA.

[62] Article 2:216 (2) Dutch Civil Code.

[63] For an overview of the different places in the preparatory works where this issue has been addressed, see Van Der Heijden and Van Der Grinten 2013, p. 744.

[64] The quick ratio equals the difference between the current assets (except inventories) divided by current liabilities.

[65] See Kamerstukken I, 2011-12, 31 058, 32427, C, 13-14. See for instance also Holtman 2013, p. 67.

[66] See Kamerstukken I 2011/12, 31 058, nr. E, 15.

[67] However, from a practical perspective, it seems advisable for companies to extensively document the decision process pertaining to the liquidity test.

### 4.2 The Dutch rules' addressees

In principle, the general meeting of shareholders holds the power to decide on distributions to shareholders.[68] However, only the balance sheet test is addressed to, and must thus be conducted by, the general meeting. The liquidity test must (and can) only be applied by the board of directors.[69] More specifically, a resolution by the general meeting pertaining to distributions will not produce any effects until the board grants approval.

According to the Dutch Civil Code, the board of directors should solely refuse approval if it is aware or should reasonably foresee that, posterior to the distribution, the company will no longer be able to pay its debts as they fall due (see *supra* paragraph 4.1). The liquidity test must thus be conducted by the board of directors and, hence, the general meeting is in principle solely concerned with the balance sheet test. Importantly, however, the company's articles of association can delegate the competence of the general meeting with regard to the balance sheet test to another company organ. Such delegation for instance allows to install a regime of interim dividends,[70] according to which the board of directors can decide, without approval of the general meeting, to distribute the profits of the running accounting year and/or the not yet reserved profits of the preceding years. The delegation of powers to the board can, however, go beyond this point either.

### 4.3 Scope of the Dutch rules



The Dutch rules are applicable to all types of distributions ("*uitkeringen*"). The central article (art. 2:216 BW) clarifies that this notion encapsulates more than just profit distributions. A definition of the concept or a closed system of allowed distribution schemes comparable to the Finnish model[71] is, however, not provided by the legislator. This means that, under Dutch law, there can be discussion about whether the distribution rules apply to transactions that qualify as "disguised distributions", *i.e.* transactions with shareholders which are not at arm's length.

With respect to share buybacks and capital reductions, the Dutch Civil Code expressly stipulates that the balance sheet and liquidity test equally apply.[72] On the other hand, the rules pertaining to share buybacks differ from the principles governing normal distributions. More precisely, the competences are distributed differently, as the directors are responsible for the balance sheet and liquidity test. Regarding capital reductions, this implies a significant deviation from the traditional approach embedded in the Second CLD in this respect. Under this traditional approach, creditor protection with regard to capital reductions is organised in a different way. More specifically, protection is largely based on a right granted to creditors to ask for additional guarantees.[73] However, according

[68] Article 2:216 (1) Dutch Civil Code.

[69] Article 2:216 (2) Dutch Civil Code.

[70] See in this respect also article 56 (5) of the Company Law Directive (former article 15 (2) Second CLD).

[71] According to the Finnish Companies Act, distributions to shareholders can only be made through a limited list of transactions. This renders all other transaction in which an advantage is granted to shareholders in absence of proper compensation prohibited. See Chapter 13, section 1, (1) Finnish Companies Act.

[72] See respectively articles 2:207 (2) and 2:208 (6) Dutch Civil Code.

[73] See articles 75 and 76 Company Law Directive (former articles 32 and 33 Second CLD).

to the Dutch legislator the liquidity test serves as a better creditor protection mechanism than the a regime centred around creditors' right to ask for additional security.

Contrary to the regime for public companies ("naamloze vennootschappen – NV") distribution rules no longer apply to financial assistance transactions,[74] *i.e.* transactions in which a company advances a loan to a third party in order to allow that person to buy shares of that specific company. Transactions of that kind within Dutch closed companies are only subject to the general rules on directors' liability and the rules on conflicts of interest, without further specific limitations.

**4.4 The fate of unlawful distributions**

Directors that approved a distribution while they were aware or should have reasonably foreseen that, posterior to the distribution, the company would no longer be able to pay its debts as they fall due, can be held liable. More specifically, all directors will be jointly liable towards the company (not the creditors) for the deficit originating from the unlawful distribution.[75] Commentators understand this "deficit" to equal the amount of the distribution plus an interest rate.[76] An important consequence of the fact that there is only liability towards the company, and not towards third parties, is that basically no claim can be brought against the directors. Even efforts of an insolvency administrator ("*curator*") in this respect will be fruitless when the directors received discharge by the general meeting.[77] Creditors can however still rely on general directors liability to hold directors liable.[78]



A director can avert liability for an unlawful dividend distributions if he manages to prove that it was not his fault that the company made the distribution and that he was not negligent in taking measures to mitigate the consequences of that distribution.[79] All liability rules apply equally to both directors and shadow directors.

Directors liability is however not the only remedy in case of unlawful dividends. The shareholder who received a distribution while he knew or should reasonably have foreseen that, posterior to the distribution, the company would not be able to pay its debts as they fall due, is obliged to pay compensation for the deficit arising from the distribution.[80] This payment obligation by the benefiting shareholders is capped to the amount of distributions they received. The liability of shareholders thus is, equally to what is the fact under the traditional approach within the Company Law Directive (*supra*), limited to shareholders acting in bad faith.

[74] See in this respect article 64 of the Company Law Directive (former article 23 Second CLD).
[75] Article 2:216 (3) Dutch Civil Code.
[76] Van Schilfgaarde 2013, p. 96.
[77] Asser et al. 2013, p. 245.
[78] Lennarts 2012, p. 186.
[79] Article 2:216 (3) Dutch Civil Code.
[80] Article 2:216 (3) Dutch Civil Code.

Interestingly, if directors did already pay compensation to the company for an unlawful dividend payment, they are entitled to reclaim this amount from the different shareholders if the conditions in that respect (as set out in the previous paragraph) are met.

## *5 New rules for the Belgian BV (2019)*

### 5.1 Introduction

In 2014 a large group of Belgian academics, under the auspices of the Minister of Justice, started preparing a comprehensive reform of Belgian company law. One of the central aspects of this reform is the modernisation of the rules for closed companies. In Belgium, these closed companies are currently known as "BVBAs",[81] but in the future they will be called "BVs",[82] following the Dutch example. The legislative proposal was approved in Parliament in February 2019.[83] The new rules will be applicable to all new closed companies from 1 May 2019 onwards and will equally apply for all existing closed companies from 1 January 2020.[84]

Flexibility is the key idea behind the modernisation of the Belgian law on closed companies. This drive towards an increased level of flexibility is clearly incentivised by competition with the neighbouring countries. In line with the closed company law reforms we have witnessed over the last decade, the Belgian reform creates more freedom to arrange matters within companies' articles of association. On one point, however, the Belgian approach goes one step further than the Dutch or any other European example. More precisely, similar to the regime under the American MBCA, the concept of legal capital is entirely abolished. This conceptual revolution of course generates important consequences. An extensive analysis of these implications falls beyond the scope of this paper. However, in the following paragraphs, we do examine the impact of the Belgian reform on the rules pertaining to distributions.



### 5.1 The novel Belgian rules pertaining to distributions

In the spirit of the Dutch legal framework for closed companies, the Belgian legislator has imposed a double test in order to determine whether companies are allowed to distribute the company's assets to their shareholders. Just like the Dutch rules, the double test under Belgian law combines a balance sheet and a liquidity assessment. Although the general meeting of shareholders in principle holds the power to decide on distributions,[85] the resolution of the general meeting will only take

[81] The acronym BVBA stands for "*besloten vennootschap met beperkte aansprakelijkheid*" or, freely translated, "closed company with limited liability".

[82] The acronym BV stands for "*besloten vennootschap*" or "closed company".

[83] See Wetsontwerp tot invoering van het Wetboek van vennootschappen en verenigingen en houdende diverse bepalingen, DOC 54 3119/022 (hereinafter: Draft law introducing the new Companies and Associations Code). Article 2 of the Draft law introducing the new Companies and Associations Code introduces all provisions of the actual new Belgian Companies and Associations Code.

[84] Articles 38 and 39 Draft law introducing the new Companies and Associations Code.

[85] Article 5:141 new Belgian Companies and Associations Code.

effect if the board of directors finds that the conditions of the liquidity test are satisfied.[86] In what follows, we discuss both components of the Belgian test.

First, the Belgian **balance sheet test**, which must be applied in all scenarios, determines the ultimate distribution margin of a company. More precisely, no distribution may be made if the net assets of the company are negative or would become negative because of the distribution.[87] However, if the company holds equity or reserves that are non-distributable by virtue of the law or the articles of association, no distribution may be made if the net assets do not exceed or would no longer exceed the amount of non-distributable equity and reserves as a result of the distribution.[88] For the application of this rule, the non-depreciated portion of revaluation surpluses must be considered as non-distributable. Moreover, some specific elements should in principle be deducted from the assets when calculating the relevant amount of net assets. More specifically, amounts not yet written off pertaining to formation and expansion costs and costs for research and development should not be included in the net assets.[89]

An important innovation is that the net assets of a company can be computed based on the most recently approved annual accounts *or any other more recent balance sheet*.[90] The latter notion refers to a document drawn up by the directors in absence of a formal approval from the general meeting. In companies where an auditor has been appointed, the document is subject to auditor control. This possibility solves formerly existing discussions in Belgian legal scholarship regarding distributions during the timeframe between the closing date of an accounting year and the formal approval of that year's annual accounts (see supra 3.3.3). Moreover, this new option provides a simple framework for distributions based on the profits of the running accounting year. Previous to the reform, this type of distributions could only be made within public companies ("NV"/"SA") which are subject to demanding conditions in that respect.[91]



Besides the balance sheet test, which reflects the idea that distributions should always stem out of a surplus, the novel Belgian Companies and Associations Code prescribes a **liquidity test** as an additional safety measure. The latter test reflects the idea that distributions should not be made at the expense of the creditors and should therefore not lead to the company's inability to repay its debts. Just like the balance sheet test, the liquidity test must be applied in all scenarios. More specifically, the board of directors should assess whether, posterior to the intended distribution and in light of all developments that can be reasonably expected, the company will be able to pay its debts as they fall due.[92] The law determines that the assessment must at least cover a period of twelve months from the date of the distribution.

[86] Article 5:143 (1) new Belgian Companies and Associations Code.
[87] Article 5:142 (1) new Belgian Companies and Associations Code.
[88] Article 5:142 (1) new Belgian Companies and Associations Code.
[89] Article 5:142 (3) new Belgian Companies and Associations Code.
[90] Article 5:142 (2) new Belgian Companies and Associations Code.
[91] See article 618 of the (old) Belgian Companies Code.
[92] Article 5:143 (1) new Belgian Companies and Associations Code.

According to the preparatory works,[93] the liquidity test cannot be limited to the mere application of a certain financial ratio. On the other hand, the test does not oblige to perform extensive future cash flow projections for every distribution. Companies with a stable portion of equity and no payment difficulties deciding to distribute a limited part of their equity may limit themselves to (i) a reference to the balance sheet and (ii) a reaffirmation of the accounting hypothesis that, to the best of the directors' knowledge, the company will remain able to pay its debts as they fall due in the coming year. When a company decides to distribute its entire equity, *e.g.* in the context of a restructuring operation, or when a company wants to make a distribution when it is already encountering payment difficulties, the liquidity test will require more effort. In such situations, a detailed analysis of future cash flows is advisable. The decision of the board of directors resulting from the liquidity test must be detailed in a report. Companies are not required to make this report publicly available nor do they have to observe formal requirements in this respect.[94] However, in companies where an auditor has been appointed, the auditor has to control the historical and prospective accounting and financial data employed in this report.[95]

**5.2 The Belgian rules' addressees**

As outlined above, the general meeting of shareholders in principle holds the power to decide on distributions, but the resolution of the general meeting will only take effect if the board of directors finds that the conditions of the liquidity test are satisfied. Solely the balance sheet test is thus addressed to the general meeting of shareholders. The liquidity test must (and can) only be applied by the board of directors.



Another novelty in the context of Belgian closed companies is that the articles of association can to a certain extent delegate the competence regarding distributions to the board of directors.[96] The board can, however, never distribute a company's reserves. Such distribution will thus always require a decision from the general meeting.

**5.3 Scope of the Belgian rules**

The relevant rules apply to all types of distributions. This includes the type of transactions that were formerly known as capital reductions.[97] Furthermore, the Belgian legislator has stated explicitly that the balance sheet and liquidity test apply in the context of share buy-backs and financial assistance

[93] See Wetsontwerp tot invoering van het Wetboek van vennootschappen en verenigingen en houdende diverse bepalingen, DOC 54 3119/001, p. 178-179.

[94] Article 5:143 (2) new Belgian Companies and Associations Code.

[95] Article 5:143 (2) new Belgian Companies and Associations Code. Upon completion of his task, the auditor states in his annual audit report that he has carried out this task.

[96] The articles of association may delegate the power to distribute (i) the profits of the current financial year or (ii) the profits of the preceding financial year (as long as the annual accounts for that financial year have not yet been approved) to the board of directors. If applicable, losses carried forward or profits carried forward must be considered. See article 5:141 (2) new Belgian Companies and Associations Code.

[97] As the Belgian reform abolishes the concept of legal capital (see *supra*), this transaction can no longer be called a capital reduction.

transactions.[98] In light of the highly complex combination of conflicts of interest which are typically at stake in this type of transactions, the lawmaker decided to preserve rules on these types of transactions.

To this traditional list of distributions, the new Belgian Companies and Associations Code adds two extra transactions to which the rules regarding distributions apply. It concerns the voluntary exit of shareholders and the expulsion of shareholders. The first procedure allows shareholders to leave the company and to receive the value of their shares out of the company's assets.[99] The second procedure allows the general meeting to exclude a shareholder from the company for "legitimate reasons" by paying out the value of his shares.[100] Before the 2019 company law reform, these procedures were only open for shareholders in cooperatives ("CVBA/SCRL"). Under the new law, closed companies can also make these procedures available in their articles of association. As potentially a large amount of assets might be leaving the company through these transactions (without the company receiving anything in return),[101] these transactions are considered as a distribution to shareholders and therefore submitted to the rules on distributions.

The new Belgian Companies and Associations Code lacks express rules on disguised distributions. A closed system of distributions is equally absent (see *supra* under 4.3). However, unlike what was the case under the old Belgian regime, the new rules seem to contain a general definition of what has to be considered as an "indirect distribution".[102] More precisely, an indirect distribution is every transaction that gives rise to a decrease in assets or an increase in liabilities, for which no compensation or a compensation that is clearly too low in light of the delivered service is obtained. This approach leads essentially to a very broad definition of indirect or disguised distributions. However, the legislator expressly indicated that the aforementioned definition should only be used for determining the difference between companies and associations.[103] Consequently, the definition cannot be employed in the context of closed companies, which leaves the issue of disguised distributions unregulated.



**5.4 The fate of unlawful distributions**

If directors assessing a company's liquidity knew or, in view of the circumstances, should have known that as a result of the distribution the company would *clearly* no longer be able to pay its debts as they fall due, they shall be jointly liable towards third parties and the company for all resulting damages.[104] Note that the Belgian legislator only leaves a marginal right of review to the Belgian courts ("*clearly*") with regard to the unlawful character of distributions.[105] In comparison to

[98] See respectively articles 5:145 (1), 2° and 5:152, §1, 3° new Belgian Companies and Associations Code.
[99] The articles of association must determine the valuation method; the historical value of the shares at the time of their issuance serves as the non-peremptory rule.
[100] With regard to valuation, the same principles apply as in case of a voluntary exit.
[101] The shares of the shareholder that leaves the company are typically annulled.
[102] Article 1:4 new Belgian Companies and Associations Code.
[103] Article 1:4 new Belgian Companies and Associations Code.
[104] Article 5:144 (1) new Belgian Companies and Associations Code.
[105] The Belgian legislator employs "*manifestement*" or "*kennelijk*" for the notion "*clearly*".

the Dutch approach, the Belgian liability regime for directors in the context of unlawful distributions definitely has a broader scope. More concretely, besides liability towards the company (as in the Dutch system), directors also risk liability towards third parties.

Besides directors' liability, the company may reclaim any distribution made in violation of the balance sheet or liquidity test from the shareholders, regardless of their good or bad faith.[106] In this regard, the Belgian rules again significantly differ from their Dutch counterparts. First, under Belgian law it is irrelevant whether shareholders were aware of the violation of any test. The Dutch rules on distributions, on the other hand, require that the shareholders knew or should have reasonably foreseen that the distribution violated the liquidity test (*i.e.* shareholders were acting in bad faith). Secondly, the Belgian principle pertains to any violation of the liquidity *or* balance sheet test, whereas the Dutch approach to unlawful distributions only considers potential violations of the liquidity test.

Belgian law does not foresee in an express possibility for directors that were held personally liable for unlawful distributions to reclaim any compensation they might have paid to the company or third parties. Directors that are no longer in office can only rely on the general rules of liability law and procedural law in that respect.

## *6 Assessment of the Dutch and Belgian approach: towards an optimal regime on distributions*



### 6.1 Overview

The reforms of the Belgian and Dutch laws on closed companies have served as a captivating real-life laboratory for the scholarly debate on creditor protection in closed companies that has been going on for many years. The fact that both reforms originated from very similar insights and objectives makes the analysis of these examples even more interesting from a policy perspective. More precisely, both legislative interventions aimed at designing a more flexible legal framework for closed companies that would still maintain a high level of third party (creditor) protection.

Given those similarities at the start, it should not come as a surprise that the Dutch and Belgian legislator employed the same source of inspiration (*i.e.* the American MBCA) for drawing up their new rules on distribution to shareholders.[107] The MBCA's key rule on distributions reads as follows: "*No distribution may be made if, after giving it effect: (1) the corporation would not be able to pay its debts as they become due in the usual course of business; or (2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution*".[108]

[106] Article 5:144 (2) new Belgian Companies and Associations Code.
[107] *Cf. supra* footnote 61.
[108] See § 6.40 (c) MBCA.

Both the Dutch and the Belgian legislator decided to employ a double test to regulate distributions to shareholders, being a combination of a balance sheet test and a liquidity or solvency test. We strongly believe that this approach, based on the MBCA-model, is most advisable as it perfectly reflects the objectives that company law rules on distributions should pursue: assuring that payments to shareholders cannot be made at the expense of creditors. The combination of both test allows to keep the ease of the balance sheet test as a bright line rule and to combine it with the more nuanced forward looking and liquidity oriented liquidity test.

Notwithstanding the very similar objectives and the identical source of inspiration, it is remarkable that still several differences between the "new" distribution rules in both countries emerged in the process of drafting the final rules. In the following paragraphs, we assess the different choices that have been made by both legislators. We will confront these policy choices with other options that were available. Against this backdrop, we try to draw up some final conclusions with regard to the optimal design of rules on distributions to shareholders in terms of effectiveness and applicability.

**6.2 A double test**

At first sight, both Belgium and the Netherlands installed a double test, which is a combination of a balance sheet test and liquidity oriented test, just like the MBCA. As explained above (see *supra* 4.2), the Netherlands decided however to strongly diminish the role of the balance sheet test, as this test must only be applied in cases where there are non-distributable reserves. Furthermore, the companies' share capital, which conceptually remained in place, should not be considered a non-distributable reserve in this respect. This results in one of the most remarkable aspects of the Dutch distribution rules; it is – at least theoretically – possible to distribute future profit capacity.

The Dutch approach deviates from the American example and actually – to the best of our knowledge – from all other regimes worldwide. Although some proposals in this respect have been advanced in academic literature[109] and many countries loosened the link between profits and distributions, no other jurisdiction so far decided to regulate distributions in absence of a balance sheet test.[110]

Belgian law follows the American tradition by making a balance sheet test obligatory in all circumstances. The strict link with the concept of profits, stemming from the system of the Second CLD, has been abandoned, but the idea of a surplus of assets over liabilities, remains in place. Preserving this "surplus idea" corresponds to the, in our view fundamental, insight that distributions should not be made at the expense of creditors. Moreover, a balance sheet test, and more in particular a simple balance sheet test, has the advantage of serving as a bright line rule for all involved parties: shareholders, directors and creditors.

[109] Richard 2007, 313 p.; Marx 2006, 242 p.; Rickford 2004, p. 919-1027.

[110] The possibility to distribute so-called nimble dividends under the company law of some American states seems to come the closest in this regard. According to this nimble dividend option, companies can distribute the profits from the running accounting year, even if there are still losses from previous accounting years on the balance sheet. See in this respect *e.g.* Black 2008, nr. 2:41.

Furthermore, the preservation of a balance sheet test, which functions as a first indication of the lawfulness of distributions, helps to overcome the complexity that follows from the liquidity test. Although the criterion enclosed in the liquidity test is intrinsically superior to the one of the balance sheet test, it cannot be denied that the liquidity test is more complex and causes more uncertainty. Therefore, the presence of a balance sheet test might help to handle this complexity, again for all parties involved. The interplay between de balance sheet test and the liquidity test is important in this respect. Most conclusive in that respect is the official comment on the American version of the liquidity test enclosed in §6.40 MBCA, called the "equity insolvency test", which reads as follows: *"In most cases involving a corporation operating as a going concern in the normal course, it will be apparent from information generally available that no particular inquiry concerning the equity insolvency test […] is needed. Although neither a balance sheet nor an income statement can be conclusive as to this test, the existence of significant shareholders' equity and normal operating conditions are of themselves a strong indication that no issue should arise under that test. In the case of a corporation having regularly audited financial statements, the absence of any qualification in the most recent auditor's opinion as to the corporation's status as a "going concern," coupled with a lack of subsequent adverse events, would normally be decisive. It is only when circumstances indicate that the corporation is encountering difficulties or is in an uncertain position concerning its liquidity and operations that the board of directors […] may need to address the issue"*.



The comment to the MBCA clarifies that the balance sheet and the state of the company's equity as reported therein is not necessarily decisive with regard to the outcome of the liquidity test. It might nevertheless serve as a clear starting point for further analysis, which may remain very limited if the company is not encountering any actual difficulties. Remarkably, this position has been expressed in the legislator's preparatory works of the Dutch 2012 reform as well. From that perspective, it would have been more logical to maintain the balance sheet test in all circumstances. On the other hand, the absence of a balance sheet test does not seem to cause significant issues in Dutch corporate practice.

What concerns the numbers to which the balance sheet test should be applied, both the Dutch and the Belgian rules are flexible, just like the US example. As the balance sheet test is accompanied by a liquidity test, it is less important to what numbers the balance sheet test is being applied. If the board of directors would propose or confirm a distribution to the general meeting based on numbers that are outdated in a negative way, without taking this into account, they will endanger their personal liability in the context of the liquidity test.

Another aspect that both rules have in common with their American example is the applicable timeframe in the context of the liquidity test. The minimal horizon to take into account is a timeframe of twelve months, which is assumed to be a period for which directors should be able to make a realistic forecast. Relevant facts outside the twelve months timeframe that are already known to the directors, should however also be taken into account. Only Belgium opted to make an express reference to the minimal period of twelve months in the rule's phrasing. The Netherlands and the MBCA only have such reference in respectively the preparatory works and the commentary to the rules. The Belgian approach is less flexible compared to the MBCA and Dutch model, but has the advantage of reducing uncertainty for directors and should be seen in combination with the rather severe new Belgian regime on unlawful distributions.

Finally, with regard to the key characteristics of the liquidity test, one cannot deny that, although the criterion used therein is most relevant from the perspective of creditor protection, it entails some vagueness and uncertainty. This is considered to be the main disadvantage of systems based on a liquidity test, and is also the aspect of the new Belgian distribution rules that has been most criticized by legal and accounting practitioners. Belgium and the Netherlands have not done much in order to decrease this level of uncertainty. Belgium expressly stipulated a minimal timeframe of twelve months (*see supra*), whereas the Netherlands did not, but suggested, in the preparatory works, not in the law, the quick ratio as a good first indication of the result of a balance sheet. Another measure by the Belgian legislator, than can be mentioned in this respect, is the requirement for the board to draw up a report indicating the elements on which it has grounded its decision on the company's capability of paying its debts as they fall due within a period of at least the upcoming twelve months. This report should not be made public, nor is any specific sanction foreseen if the report is not there. Moreover, it is accepted that the content of the report can remain very limited if there are no elements to doubt the company's actual and future ability to repay its debts. The, somewhat paternalistic, idea behind this reporting requirement is that it protects directors if their decision on the liquidity test is being challenged in the future. Furthermore, the introduction of this report was necessary in companies that are obliged to appoint an auditor, to allow this auditor to scrutinize the application of the liquidity test. In our view, however, requiring a report for every distribution, might render the procedure unnecessary burdensome. Contrary to the MBCA model, the Dutch and Belgian legislators did not determine the specific moment on which the directors should place themselves if they assess whether the company will remain able to repay its debts as they fall due.[111] This creates an extra level of uncertainty, as it is unclear whether directors must consider the moment of the decision or the moment of the effective payment of the distribution.



**6.3 The rules' addressees and scope**

The approach in Belgium and the Netherlands with regard to the addressees of the rules on distributions is very similar. The general meeting and the board of the directors are both assigned their proper role in deciding on profit distributions. This differs from the approach under the MBCA, according to which the full competence regarding distributions rests with the board of directors. The Belgian and Dutch approaches correspond with the European tradition regarding distributions, according to which no distribution can be made without a decision from the general meeting. A slight difference between the Belgian and Dutch rules that can be mentioned in this respect, concerns the possibility for the general meeting to delegate its power regarding distributions to the board. Dutch law is more flexible in that respect compared to Belgian law. In the Netherlands, the general meeting can delegate all of its powers regarding distributions to the board. In Belgium, the delegation must remain limited to the distribution of the profits of the running accounting year or

[111] See in this respect §6.40, (e), (3) MBCA according to which the effect of a distribution must be measured as of (i) the date the distribution is authorized if the payment occurs within 120 days after the date of authorization or (ii) the date the payment is made if it occurs more than 120 days after the date of authorization.

not yet reserved profits of previous years. The Belgian legislator was reluctant to allow the board of directors to amend earlier decisions from the general meeting with regard to the reservation of profits. It is however doubtful whether this is a righteous reasoning. If the general meeting wants to delegate its full competence regarding distributions, but wants the board to refrain from the distribution of certain reserves, the general meeting can create a regime in that respect in the articles of association.

What concerns the scope of the rules on distributions, the Belgian and Dutch legislator made similar choices too. However, two differences can be mentioned. First, in Belgian closed company law, capital reductions do no longer exist as a result of the abolishment of the concept of legal capital. From a company law perspective,[112] the origin of the equity that is being distributed does no longer matter. Contributions, share premiums, profits, reserves, etc. are all treated alike. Although the Netherlands also apply the double distribution test for capital reductions, the regime still differs from the Belgian approach in terms of requirements on qualified majorities and a notarial deeds. In Belgium, no notarial deed and a simple majority suffices to distribute assets that have been contributed to the company's equity in return for shares. A second difference concerns financial assistance transactions, for which the Belgian legislator decided to keep a specific rule, whereas the Netherlands abolished all specific legislation with regard to these transactions, thereby treating them in the same way as all other credit transactions initiated by a closed company. Whereas the Netherlands has opted for flexibility in this respect, Belgium preferred to avoid too much uncertainty for parties involved in financial assistance transactions. The Belgian regime remains, however, a light version of the regime applicable for public companies according to article 23 of the Second CLD. The key limitation for closed companies is that financial assistance can only be provided out of assets that could have been distributed to the shareholders according to the double distribution test.[113]

Finally, none of the investigated regimes expressly addresses the issue of disguised distributions, which means that the legislators leave it to the courts to decide whether a transaction should be considered as a distribution. Interestingly, the Belgian legislator inserted a definition of what has to be considered a distribution into the general provisions of the new code. This definition could have provided a solution for this phenomenon, but the legislator decided to expressly limit its application to the conceptual distinction between companies and associations. The presence of such a definition would have been in line with the approach embodied in the MBCA.[114] Another, even more straightforward, approach in this respect that would have deserved the attention from the Belgian and Dutch legislator, can be found in Finland. According to Finnish company law, assets can only be distributed to the shareholders through four transactions: (1) distributions of profits, reserves or unrestricted equity, (2) capital reductions, (3) acquisition and redemption of own shares and (4)



[112] For tax purposes, there are still differences.

[113] See article 5:152 of the new Belgian Companies and Associations Code.

[114] See §1.40 MBCA: *"'Distribution' means a direct or indirect transfer of cash or other property (except a corporation's own shares) or incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares. A distribution may be in the form of a payment of a dividend; a purchase, redemption, or other acquisition of shares; a distribution of indebtedness; a distribution in liquidation; or otherwise"*.

dissolution of the company.[115] Other transactions that reduce the assets of the company or increase its liabilities without a sound business justification are considered unlawful distributions.

### 6.4 Unlawful distributions

The topic of unlawful distributions received broad attention, both in the Netherlands and Belgium. As indicated before, an effective enforcement mechanism, properly determining the role of directors, is key to a well-functioning liquidity test. In the Netherlands, the legislator could build on the existing High Court jurisprudence on unlawful distributions (see *supra* under 3.3.3). In Belgium, however, the role and liability of directors in proposing and paying out distributions had hardly been discussed prior to the adoption of the new Companies and Associations Code. The liability risk of directors regarding distributions under the liquidity test has therefore been one of the more debated issues of the Belgian reform.

The starting point of the enforcement mechanism in the Netherlands and Belgium is identical. Directors can be held liable for unlawful distributions, but only to the extent that they have committed a fault in their assessment of the company's ability to repay its debts as they fall due. The mere fact that a company goes bankrupt within a limited timeframe after it has made a distribution is not enough to hold directors liable. Proof has to be delivered that the directors took a decision that would and should not have been taken by an average director in the same circumstances. The report that directors have to draw up when executing the liquidity test according to Belgian law, will play an important role in delivering that proof. However, the question remains whether that benefit outweighs the considerable cost of this obligation.



Furthermore, both regimes explicitly address the impact on the shareholders of unlawful distributions. The Netherlands limits the possibility to reclaim unlawful dividends to shareholders that acted in bad faith. The Belgian legislator took the daring decision to make it possible to reclaim unlawful distributions from shareholders in all cases, irrespective their good or bad faith. The latter approach better enshrines the idea that it cannot be allowed that distributions are being made at the expense of the creditors. Moreover, in a Belgian setting, this option is perceived as a counterweight for the increased liability risk of directors, which are basically not benefitting from the unlawful distribution. In that respect, it is regrettable that the Belgian legislator, contrary to Dutch law, did not pay attention to the question to what extent directors that paid a compensation for unlawful dividends, can reclaim (part of) this compensation from the shareholders.

## *7 Conclusions*

In this contribution we have examined how the Dutch and Belgian legislator fundamentally departed from the traditional European approach regarding the regulation of distributions to shareholders through reforms of their laws on closed companies. Both legislators have opted for the combination of a balance sheet test and a liquidity or solvency test. We are convinced that this combination

[115] Chapter 13, section 1, (1) Finnish Companies Act.

perfectly reflects the ideas that should be at stake when regulating distributions to shareholders. More precisely, distributions may only be made out of a "surplus" and should not leave the company unable to repay its debts. In other words, distributions should not be made at the expense of a company's creditors. Furthermore, a combination of both rules allows each of the rules to solve the drawbacks of the other rule. The balance sheet test helps to overcome the uncertainty and difficulty that follows from the liquidity test, while the liquidity test solves the unqualified and not-forward-looking character of the balance sheet test.

Both the Dutch and the Belgian legislator have been strongly inspired by the rules on distributions from the American MBCA, which is a model that has been functioning well for many years. Despite this identical source of inspiration and the similar overall objectives, still many small differences between the Dutch and Belgian model exist. Overall, the Dutch model could be considered slightly more flexible compared to the Belgian one: the balance sheet test is not always mandatory, there is no report required, the horizon for the liquidity test is not indicated, there are no rules on financial assistance anymore and unlawful dividends can only be reclaimed from shareholders acting in bad faith. Some of these flexibilities can however not be considered as a plus from the perspective of effectiveness of the rules that are aimed at protecting creditors. Therefore, we do not consider one of both regimes clearly superior to the other.



In general, the fundamental reform of the laws on closed companies in Belgium and the Netherlands significantly increased the differences between the rules for closed and open or public companies (NV). For many topics, this can be considered as a positive evolution, which renders the existence of separate regimes more useful. When it comes to distributions to shareholders, we doubt however whether this difference can be justified, as the purpose of the rules has nothing to do with the internal organization of the company but envisions the protection of third parties. Nevertheless, none of both countries has decided to implement the new approach to limiting distributions to shareholders for public companies. The option of adding a liquidity oriented test to the existing net assets test for public companies has nevertheless been discussed in both countries during the preparatory legislative phase. Maybe the experiences with a liquidity test in the context of closed companies will pave the way for a similar approach for public companies in the future. The Belgian and Dutch reforms in any case add two names to the list of EU member states that have experiences with liquidity tests. This strongly increases the feasibility of inserting such a rule on the EU level when policymakers ever plan to update the rules of the current Company Law Directive, which still reflects the approach as introduced by the Second CLD.

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