

# Study on Creditor Remedies in Corporate Capital Reduction

Zixuan Yu

Xinjiang University Law School, Xinjiang University, No. 666, Shengli Road, Urumqi, Xinjiang, China

yuzixuan\_sunny@126.com

**Abstract.** This paper aims to study the remedies available to creditors in the context of corporate capital reduction. It explores the risks and challenges faced by creditors during the process of corporate capital reduction and discusses measures to safeguard their rights and interests. Firstly, it introduces the concept and background of corporate capital reduction, analyzing the potential losses that creditors may suffer in this process. Subsequently, it provides a detailed analysis of the legal framework surrounding corporate capital reduction, including legal regulations, procedures, and a comparison of creditor protection mechanisms under different legal systems. In terms of remedies available to creditors, it examines the exercise of recovery rights, applications for preservation orders, as well as the deadlines and requirements of remedial procedures. By conducting practical case studies, it summarizes the practical experience and effective methods for creditors' remedies. Lastly, it offers suggestions for improving creditor protection measures, such as enhancing laws and regulations, strengthening supervision, and promoting information disclosure. This study provides valuable insights for protecting the rights and interests of creditors in corporate capital reduction. It also contributes to the further enhancement of creditor protection mechanisms by relevant institutions and legislators, thereby fostering the rational development of corporate capital reduction.

**Keywords:** Corporate capital reduction, Creditors, Relief issues.

## 1. Introduction

With the development of the global economy and the improvement of corporate governance, corporate capital reduction has been widely utilized as an important corporate restructuring method. Corporate capital reduction can help optimize capital structure, reduce leverage, improve profitability, and create greater value for shareholders. However, during the process of corporate capital reduction, creditors often face a series of risks and challenges. Corporate capital reduction may lead to the impairment of creditor rights, and creditors may encounter difficulties in recovering their claims, loss of creditor rights and even face bankruptcy risks. Therefore, ensuring the protection of creditors' rights and interests in corporate capital reduction becomes a critical issue in the study of corporate capital reduction. This paper aims to conduct an in-depth study on the remedies available to creditors in the context of corporate capital reduction, exploring the measures and avenues for the protection of creditors' rights and interests during the process.

## 2. Legal framework for corporate capital reduction

### 2.1 Legal provisions and procedures for corporate capital reduction

The legal framework for corporate capital reduction varies from country to country and region. Here are the general provisions and procedures for corporate capital reduction: According to the laws of most countries or regions, corporate capital reduction typically requires following certain procedures and regulations. Firstly, the company must convene a shareholder meeting and provide prior notice of the capital reduction proposal. During the meeting, the company should clearly explain the reasons, objectives, plans, and steps involved in the capital reduction to the shareholders. Secondly, shareholders must vote on the reduction proposal and pass the resolution according to the statutory or agreed-upon majority. In certain cases, specific categories of shareholders or special majority percentages may be required to approve the reduction proposal. Thirdly, once the reduction

proposal is approved by the shareholder meeting, the company must apply for approval from the relevant government departments or regulatory agencies and submit the necessary documents and information to comply with the prescribed procedures [1]. These documents typically include the resolution on capital reduction, audit reports, financial statements, and others. Finally, after obtaining the approval from the government department or regulatory agency, the company can formally implement the capital reduction. This may involve changing the registered capital, amending articles of association, or registered documents, among other procedures. It is important to note that different legal systems may have varying provisions and procedures for corporate capital reduction. Therefore, in the actual operational process, companies should comply with applicable laws and regulations, and seek professional legal advice or guidance from relevant institutions when necessary. In summary, the legal framework for corporate capital reduction generally includes convening shareholder meetings, voting, applying for approval, and implementing the reduction. These procedures aim to ensure that the capital reduction is conducted lawfully and in compliance with regulations, while protecting the rights and interests of relevant stakeholders.

## 2.2 Possibility of impairment of creditors' rights and interests

In corporate capital reduction, there is a possibility of impairment of creditors' rights and interests. Here are some situations that may lead to the impairment of creditors' rights:

**Asset devaluation:** Capital reduction may result in the devaluation of the company's assets, especially when the company's capital strength decreases significantly after the reduction. This may render the company unable to meet its debt repayment obligations, leading to insufficient protection of creditors' rights. Creditors may face the risk of not being able to recover their principal and interest in a timely manner, and even face the possibility of unenforceable debt claims.

**Imbalance in creditor ratios:** After capital reduction, the proportion of the company's assets to its liabilities may be disrupted, causing a reduction in creditors' claims relative to the company's assets. Particularly when the company's liabilities exceed its assets, capital reduction may result in significant losses for creditors in terms of asset distribution, making it difficult for them to recover their rightful creditor rights.

**Fair distribution issues:** In corporate capital reduction, if equity or compensation arrangements are unreasonably allocated, creditors' interests may be overlooked. If the company primarily distributes equity or compensation to other shareholders or specific stakeholders while not adequately protecting creditors' rights, creditors may suffer losses due to reduced capital or unfair compensation [2].

**Inability to fulfill partial debts:** In the process of corporate capital reduction, there may be situations where some debts cannot be fully settled. When the company chooses to settle debts, it may not be able to repay all debts at once and can only do so in proportion. This may result in creditors being unable to fully recover the owed amount, leading to losses.

**Legal restrictions:** Corporate capital reduction may be subject to legal restrictions, such as specific procedures and decision requirements under company law or articles of association. If the company does not follow the prescribed procedures for capital reduction, creditors may face legal limitations and be unable to effectively protect their rights.

In the face of these risks, creditors should take active measures to protect their rights and interests. They can request the company to provide capital reduction plans and financial information and negotiate compensation schemes with the company. Creditors can also seek legal remedies through relevant laws and regulations, such as suing the company or applying for preservation measures, to safeguard their rights. Seeking timely professional legal advice and collaborating with other creditors in this process is also an essential strategy for protecting creditors' rights and interests.

## 2.3 Comparison of creditor protection mechanisms under different legal systems

There may be differences in the mechanisms and levels of creditor protection in different legal systems. Here is a comparison of creditor protection mechanisms in some common legal systems:

**Common Law System** (e.g. United States and United Kingdom): In these countries, creditors generally enjoy a higher level of protection. Company laws require companies to fulfill contractual obligations and protect the interests of creditors. Creditors have the right to participate in decisions regarding debt repayment, capital reduction, and other matters. Additionally, these systems often have bankruptcy procedures in place to protect the rights of creditors and ensure fair distribution of debt.

**Civil Law System** (e.g. France and Germany): Company laws in civil law systems tend to prioritize the stability and long-term interests of companies and their creditors. Creditor rights are often protected in restructuring or bankruptcy procedures, and appropriate procedures are prescribed by law to ensure debt repayment. Moreover, creditors in civil law systems typically have higher participation rights and can influence the approval process of restructuring and bankruptcy plans.

**Mixed Systems of Common Law and Civil Law** (e.g. China and Japan): In these systems, company laws are often developed based on the legal traditions and practices of each respective country. Creditor protection mechanisms in these systems may be flexible and adjusted according to specific circumstances. Creditor rights are often protected by the limitations and procedures prescribed by company laws, but the specific level of protection may vary based on national legislation and judicial practices.

It is important to note that the above is just a general overview of creditor protection mechanisms in different legal systems and may not cover all details and variations. Specific creditor protection mechanisms can be influenced by legal regulations, judicial precedents, and national practices. Therefore, in specific situations, creditors should assess and protect their rights based on local laws and professional legal advice.

### **3. Creditor remedies in corporate capital reduction**

#### **3.1 Exercise of creditor recovery rights**

In the context of corporate capital reduction, the exercise of creditor's recovery rights is a common relief measure. Creditors have the legal recourse to recover their rightful claims. The exercise of creditor's recovery rights involves various methods and procedures. Here are some common ways in which creditors can exercise their recovery rights:

Firstly, creditors can demand early repayment of debt. In the event of corporate capital reduction, creditors can assert their priority rights and request the company to repay the debt in accordance with the terms of the debt agreement. Creditors can negotiate an early repayment agreement with the company or seek compulsory repayment through legal procedures. Early repayment ensures that creditors can recover their rightful claim amounts prior to the capital reduction, thereby avoiding further losses.

Secondly, creditors can enforce security interests. If the debt is secured by collateral, creditors can exercise their right to claim the collateral. By requesting the company to sell the collateral or through judicial procedures to dispose of the collateral, creditors can recover their rightful claim amounts. Creditors must comply with relevant legal procedures and requirements when enforcing security interests to ensure the lawful and effective exercise of their rights.

Thirdly, creditors can seek enforcement against the company. In situations where creditors' rights are harmed due to corporate capital reduction, creditors can resort to legal recourse and seek enforcement against the company. Creditors can file a lawsuit with the court, demanding the enforcement of their claims, including debt repayment, asset freezing, or property seizure of the company. Enforcement measures can ensure that creditors' legal rights are effectively protected [3].

Additionally, creditors can participate in a creditor committee or creditor meeting. During the process of capital reduction, creditors can form a creditor committee or participate in a creditor meeting to collectively act in the best interests of the creditors. The creditor committee can represent the creditors in negotiations, discussions, and consultations with the company, ensuring that creditors can exercise their rights collectively and enhance their bargaining power.

In summary, creditors can protect their interests in corporate capital reduction by exercising their recovery rights. The exercise of creditor's recovery rights includes demanding early repayment of debt, enforcing security interests, seeking enforcement actions, and participating in a creditor committee or creditor meeting. By exercising their recovery rights, creditors can safeguard their legal rights and minimize the risks and losses they may face in corporate capital reduction.

### **3.2 Procedures and effects of preservation applications against companies**

A preservation application against a company is another remedy for creditors in a corporate capital reduction. The purpose of a preservation application is to ensure that creditors' rights and interests are effectively protected and to prevent the company from taking actions that might jeopardize creditors' rights and interests. The following are the general procedures and effects of a preservation application against a company:

**Procedure:** First, the creditor needs to file a written application for preservation with the relevant court. The application needs to detail the creditor's rights and interests, list the acts that may harm the creditor's rights and interests, and provide relevant evidence and reasons to support the application. The application may need to include specific requirements for applying for preservation, such as seizure of property, freezing of funds or other appropriate measures. The court will then examine the application for preservation. The court will carefully assess the reasonableness and urgency of the application to determine whether to take preservation measures. During the review process, the creditor may need to provide further evidence or additional information to support the application. Finally, based on the results of the review, the court will make a ruling on preservation. The ruling determines whether or not to take preservation measures and provides for specific preservation measures. When the preservation ruling enters into force, the creditor may implement the preservation measures directed by the ruling to protect the interests of its claim.

**Effect:** The effect of applying for an injunction is to ensure the protection of creditors' rights in a corporate capital reduction. Through the injunction, creditors can prevent the company from taking actions that may harm their interests and ensure that the company's assets and funds are not transferred, assigned, or concealed. The specific effects include:

**Asset freeze:** The injunction allows creditors to apply for the freezing of the company's assets, preventing the company from transferring assets to others or reducing their value in any other way. This ensures that creditors can obtain the corresponding return by performing their obligations during the capital reduction process.

**Property attachment:** Through the injunction, creditors can apply for the attachment of the company's property. This will restrict the company's right to deal with and dispose of the property, providing guarantees for creditors to obtain better debt recovery during the capital reduction.

**Protection of creditor ranking:** The injunction can ensure that creditors' claims enjoy priority, allowing them to be repaid first during the corporate capital reduction. This safeguards the interests of creditors and prevents them from being treated unfairly during the reduction process.

In summary, the procedure for applying for an injunction against the company includes initiating the application, reviewing the application, and determining the injunction. The effect is to protect creditors' rights, prevent actions that may harm creditors' interests by the company, and ensure that creditors receive the appropriate protection and return on their debts during the corporate capital reduction.

### **3.3 Time limits and requirements for relief proceedings**

The time limits and requirements for relief proceedings will vary depending on the legal system, the court and the nature of the case. The following are some common time limits and requirements, but please note that these are intended as a general guide only:

(1) **Time limit for filing relief applications:** In most cases, relief applications must be filed within a certain time limit. This time limit can be a fixed period, such as 30 days, 60 days, etc., or a reasonable

period determined based on the specific circumstances. Creditors must ensure that relief applications are submitted within the prescribed time limit, otherwise they may lose the opportunity for relief.

(2) Requirements for relief applications: Relief applications need to meet certain requirements to be accepted by the court. These requirements may include providing a written application, stating the facts and legal basis of the application, submitting relevant evidence and documents, etc. Creditors need to carefully understand and comply with the specific requirements of the court for relief applications to ensure their effectiveness.

(3) Notice period and notification requirements: Sometimes, before filing a relief application, creditors may need to go through a prior notice or notification procedure. This is usually applicable to cases that require notifying other interested parties or the general public. Creditors need to comply with relevant notice periods, methods, and requirements to ensure the legality and effectiveness of the procedure.

(4) Submission requirements for materials and evidence: When applying for relief, creditors need to prepare and submit necessary materials and evidence to support their relief request. This may include relevant contracts, financial records, copies of documents, witness testimonies, etc. Creditors need to ensure that the submitted materials and evidence are clear, complete, and comply with the court's requirements.

It is important to note that the time limits and requirements may vary depending on different jurisdictions, specific legal provisions, and the nature of the case. Therefore, in specific circumstances, creditors should seek professional legal advice and accurately follow and meet the relevant time limits and requirements set by the court. This will ensure that creditors can fully exercise their rights to relief and obtain a legally valid relief procedure [4].

## **4. Improvement of creditor protection measures**

### **4.1 Improvement of relevant laws and regulations**

In order to improve the protection measures for creditors, it is crucial to establish and improve relevant laws and regulations. These laws and regulations should focus on the following aspects: Firstly, the recognition and protection of creditors' rights. The relevant laws and regulations should clearly define the rights of creditors, including the recognition, recovery, and priority repayment of debts. At the same time, clear litigation procedures and relief mechanisms should be established to ensure that creditors can exercise their rights and obtain timely relief. Secondly, strengthening the disclosure obligations of debtors. The relevant laws and regulations should specify that debtors have an obligation to provide creditors with sufficient, accurate, and timely financial and operational information. Creditors should have the right to access relevant information in order to assess the debtor's financial condition and ability to repay debts and take necessary protective measures. Thirdly, establishing a sound guarantee system. The relevant laws and regulations should establish norms for guarantee contracts and security rights, and provide systems for the registration, enforcement, and liquidation of guarantees. This can strengthen the protection of creditors' interests in the collateral and enhance their ability to recover debts. Fourthly, improving the debt restructuring and bankruptcy system. The relevant laws and regulations should establish procedures for debt restructuring and bankruptcy to address situations where debtors face financial pressure. In the process of restructuring and bankruptcy, a creditors' committee should be established to ensure that the interests of creditors are fully taken into account. Fifthly, strengthening judicial protection. The relevant laws and regulations should emphasize the effective protection of creditors' rights by judicial authorities. This includes providing a fast, fair, and efficient judicial process, strengthening the careful review of creditors' relief requests, to ensure that creditors can effectively exercise their rights. In the process of improving the relevant laws and regulations, it is important to draw on the best practices and experiences from both domestic and international contexts, while taking into account the country's specific circumstances and legal development goals. This can help establish a regulatory framework

focused on protecting creditors' rights, providing necessary protection and security to creditors, and promoting economic development and social stability.

#### **4.2 Improved monitoring and traceability mechanisms**

To further enhance the protection measures for creditors, it is necessary to strengthen monitoring and tracing mechanisms. These mechanisms aim to ensure that creditors can more effectively supervise and track the actions of debtors, thereby safeguarding the interests of creditors. Here are some possible measures: Firstly, establish a debtor information disclosure and regulatory platform. Relevant authorities can establish a centralized platform where debtors disclose important financial, operational, and debt-related information. Creditors can access real-time information about debtors on this platform, including debt status, repayment capacity, repayment records, etc. This will provide creditors with more information and data for effective monitoring and evaluation. Secondly, enhance the enforcement capacity and resource allocation of regulatory agencies. Sufficient enforcement capacity and resource support can ensure that regulatory agencies effectively supervise and track the actions of debtors. Regulatory agencies should conduct regular inspections of debtors, promptly identify and address issues that may threaten the interests of creditors, and ensure adequate protection of creditors' rights. Thirdly, establish risk alert and early warning mechanisms. Regulatory agencies can establish risk alert and early warning systems to alert potential risks and issues through data analysis and risk assessments. Creditors can timely obtain relevant risk alerts and early warning information, take appropriate protective measures, and reduce risk losses. Fourthly, strengthen tracing mechanisms and legal accountability. When fraudulent activities, misappropriation of funds, or other illegal behaviors by debtors are discovered, creditors should have the right to trace assets and seek legal accountability. The relevant laws and regulations should stipulate that creditors have the right to seek legal remedies and participate in related tracing procedures to safeguard their own rights and promote the implementation of the law. Lastly, strengthen international cooperation and information exchange. Debtors' actions may cross borders, so international cooperation and information exchange are essential for strengthening monitoring and tracing mechanisms. Regulatory agencies in different countries and regions should enhance cooperation, share intelligence and data, and jointly address debt issues and fraudulent activities on a global scale. By improving monitoring and tracing mechanisms, creditors can more effectively supervise the actions of debtors and take appropriate measures to protect their own interests when necessary. This will enhance creditors' confidence and promote the development of a healthier and sustainable debt market. Meanwhile, the monitoring and tracing mechanisms also contribute to maintaining economic stability and social fairness and justice [5].

#### **4.3 Enhancing information disclosure and transparency**

To strengthen the protection measures for creditors, it is essential to enhance information disclosure and transparency, ensuring that debtors provide creditors with sufficient, accurate, and timely financial and operational information. This requires the establishment of a mandatory information disclosure system, which requires debtors to disclose key financial data, operational status, debt situation, guarantees, and risk factors to creditors. Additionally, regulations and standards should be developed to ensure the accuracy and reliability of the disclosed information, facilitating creditors in their assessment and decision-making processes. Such a system will provide transparency, enabling creditors to have a comprehensive understanding of the debtor's condition, thereby better evaluating risks and taking necessary protective measures. Furthermore, technology can be utilized to establish online platforms or databases for storing and disseminating disclosed information, facilitating creditors in staying updated on the debtor's latest developments. This open and transparent information environment contributes to building trust and enhancing investors' confidence in the debt market, promoting the development of a healthy and stable financial system.

## 5. Conclusion

The issue of creditor relief in company capital reduction has always been a topic of great interest as it involves the protection of creditors' rights and the healthy development of businesses. In this study, we have delved into how to reasonably safeguard the rights of creditors during the capital reduction process and put forth some suggestions and solutions. Firstly, we recognize that creditors face numerous challenges during the capital reduction process, such as compromised rights and information asymmetry. Therefore, creditors should take proactive action by demanding detailed capital reduction plans and financial information from the company to evaluate the impact on their rights. At the same time, creditors should seek fair and equitable compensation schemes and strive to protect their rights through negotiations, legal actions, and other means. Secondly, we emphasize the importance of adhering to principles of legality, compliance, fairness, and justice when dealing with creditor disputes. Whether it is the company or the creditors, everyone should abide by laws and regulations to ensure the fairness and impartiality of dispute resolution. This also helps foster harmony and collaboration between the company and creditors, providing both parties with a fair platform. Furthermore, we propose some recommendations to strengthen creditor protection measures. These include establishing more comprehensive legal frameworks to clarify creditors' rights and relief mechanisms, strengthening supervision and enforcement by regulatory authorities to ensure effective protection of creditors' rights, and enhancing debtor information disclosure and transparency to enable creditors to have a more comprehensive understanding of the debtor's situation. Lastly, we emphasize that the study of creditor relief is an ongoing and dynamic process. With the continuous development of the socio-economic landscape and changes in institutional environments, the solutions to creditor relief issues will also evolve and adapt. Therefore, we encourage scholars, government agencies, and the business community to remain attentive to and study this issue continuously, seeking better creditor protection measures to promote the healthy development of businesses and economic stability. In conclusion, in the study of creditor relief in company capital reduction, we have put forth a series of suggestions and solutions aimed at protecting creditors' rights and fostering the healthy development of businesses. We hope that this research provides valuable insights for relevant stakeholders and serves as inspiration for future research endeavors.

## References

- [1] Dai L. Research on the Protection of Creditors' Interests under the Reform of Corporate Capital System[J]. *Academic Journal of Business & Management*, 2022, 4(15).
- [2] Rongbing X, Guangzhong L, Yulan W. Environmental Protection Tax and Corporate Capital Structure[J]. *Emerging Markets Finance and Trade*, 2022, 58(12).
- [3] Yogesh C, Manju J, Vinay G. Does societal trust affect corporate capital structure? [J]. *Emerging Markets Review*, 2022, 51(PA).
- [4] Yiheng L, Chenxi J. The Impact of Corporate Capital Structure on Financial Performance Based on Convolutional Neural Network. [J]. *Computational intelligence and neuroscience*, 2022,2022.
- [5] Bo Y, Liu G. Contingent capital, Tobin's q and corporate capital structure [J]. *The North American Journal of Economics and Finance*, 2020 (prepublish).