Liquidity Extraction & Creditor Protection

Capital Maintenance and Directors' Duties

Research question: To what extent do capital-maintenance rules and directors' duties protect creditors against shareholder payouts that jeopardise the company's ability to meet its obligations?

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Liquidity Extraction

The pursuit of profit and the provision of shareholder returns are central concerns of commercial corporations. In Friedman's influential account, corporate executives should pursue shareholders' objectives, generally understood as increasing profits within legal and ethical constraints.[1] Rathenau offers a contrasting perspective: the large enterprise has an enduring economic and social significance that cannot be reduced to the preferences of its individual shareholders, particularly those seeking short-term gains.[2] These perspectives draw attention to a potential tension between shareholders' demand for returns and the enterprise's continuing financial needs. That tension becomes particularly relevant when corporate resources are transferred to shareholders. The company's assets constitute a pool distinct from shareholders' personal property, and shareholder payouts are subject to applicable statutory requirements and the company's constitution.[3] Possession of substantial assets does not, however, establish either the existence of distributable profits or the availability of sufficient cash to make a payment. Cash dividends and share buybacks are basic mechanisms of liquidity extraction, providing a starting point for examining more complex transactions and financing arrangements.

Beyond traditional dividends and share buybacks, this paper examines more advanced structures and financing arrangements, including dividend recapitalisations, the use of payment-in-kind (PIK) notes to finance shareholder payouts, and preferred-share arrangements involving distributions or redemptions. The analysis distinguishes the mechanism through which

[1]Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits", The New York Times Magazine (13 September 1970)

[2]Walther Rathenau, Vom Aktienwesen: Eine geschäftliche Betrachtung (S. Fischer 1917). For discussion of the enterprise–shareholder contrast, see Holger Fleischer, "Walther Rathenau, Vom Aktienwesen. Eine geschäftliche Betrachtung (1917)" (2017) 72 JuristenZeitung 991–994, especially 992–994.

[3]Henry Hansmann and Reinier Kraakman, "The Essential Role of Organizational Law" (2000) 110 Yale Law Journal 387–440, 393–395; Companies Act 2006, s 830.

shareholders receive value from the financing used to make that transfer possible, examining their combined effects on the company's liquidity and future payment obligations. Although a payout may convey management's confidence in the company's prospects, its occurrence does not establish that the company's finances are sustainable.[4] The resulting tension extends beyond shareholders and the enterprise to creditors, whose prospects of repayment depend on the resources and cash flows remaining available. It therefore becomes necessary to examine how capital-maintenance rules and directors' duties address liquidity extraction across these different structures and protect the company's ability to meet its obligations.

Creditor protection against liquidity extraction can be examined through two interacting forms of legal constraint, which stacks upon each other: directors' duties and capital-maintenance rules

The first layer is made up by the directors' duties towards the corporation. Directors are appointed and they ought to act in the best interest of the company within the power conferred. This general rule limits the scope of authority and action consequently of directors and sets a path for recognising what can be challenged and on which grounds. However, for many years it was debated what the "company's interest" concerned, more specifically whether directors should care only shareholder's benefits, or whether they must consider the position of the other stakeholders. For the sake of coherence, we are going to exclude non-contractual stakeholders (thus all the stakeholders other than creditors) and focus mainly on the position of creditors. In the UK this question was answered by the UK Supreme Court case BTI 2014 LLC v Sequana SA [2022] UKSC 25. The Sequana case established the rule of thumb for determining the position of creditors in

[4]Alon Brav, John R. Graham, Campbell R. Harvey and Roni Michaely, "Payout Policy in the 21st Century" (2005) 77(3) Journal of Financial Economics 483–527, section 5.4.1, 511–512 (information conveyed by payouts).

respect of fiduciary duties (of directors). More specifically the court established that directors do not have a direct fiduciary duty towards creditors individually, however they must balance their interest, especially when the company is in financial distress or if the insolvency is material and imminent. Additionally, according to the Court, the mere risk of future insolvency is not enough. However, in cases that are beyond-rescue, and thus heading towards liquidation, then the creditor's interest becomes paramount.[5]

The second layer is made up of capital maintenance provisions. These rules impose transaction-specific restrictions on distributions and other returns of capital to shareholders. Their requirements vary between jurisdictions and mechanisms. For example, UK Companies Act 2006, s 830 restricts distributions to profits legally available for that purpose, while s 831 imposes an additional net-assets restriction on public companies. In Delaware, DGCL §170 generally permits dividends from surplus or, where no surplus exists, qualifying net profits, subject to statutory conditions; purchases and redemptions of the company's own shares are governed separately by §160. These restrictions operate alongside directors' duties, so satisfying the applicable distribution requirements does not necessarily resolve whether directors have discharged their obligations in approving the transaction[6]

Taken together, these two layers of protection should constrain shareholder payouts that jeopardise the company's ability to meet its obligations. However, compliance with capital-maintenance requirements does not, by itself, establish that a payout is appropriate in the company's financial circumstances. A distribution supported by legally available profits or

[5]Companies Act 2006, ss 170, 171, 172, 178; BTI 2014 LLC v Sequana SA [2022] UKSC 25, especially [11]– [14], [78]– [90] and [203]. The judgments must be read with their differences on the precise trigger and directors' knowledge; the draft's trigger wording requires correction, as explained in the accompanying review.

[6]Companies Act 2006, ss 830, 831; DGCL §§160 and 170; BTI 2014 LLC v Sequana SA [2022] UKSC 25, [158]–[161].

reserves may nevertheless raise concerns about the resources needed to meet outstanding obligations and the repayment burden of any associated financing. Directors' duties therefore remain relevant to assessing the decision, even where the applicable distribution requirements have been satisfied.[7] The central question is whether these two layers operate together effectively: whether the restrictions governing liquidity extraction, alongside the duties governing directors' judgment, adequately protect creditors while preserving room for legitimate commercial decisions.

Why Capital safeguards are important

In corporate law Capital maintenance rules are essential, as they constitute a safeguard for creditors and third parties that may have a legal interest in the company. Thus, CM rules prevent directors from an improper use of their authority in the matter of financing. When dealing with debt, the tension arises between the creditors and the directors of a company. Correspondingly if the issuance concerns equity the parties involved will contextually be the shareholders and the directors. This economic theory, named the Agency Cost, was developed in the '70 by several academics, mainly Jensen and Meckling.[8] The core idea was that not always the interests of the two parties were perfectly aligned, as the same assets serve for them different purposes. More specifically, creditors wish to recover the amount lent (with the agreed interest rate), whether the directors want to grow both the company and their reputation (or compensation). Perhaps an example can further clarify this inverse correlation:

Suppose that Company A is in financial distress, and it needs 100 units to cover the existing debt. To solve it, it decides to borrow an additional 20 units that are going to be invested in a

[7]BTI 2014 LLC v Sequana SA [2022] UKSC 25, [158]– [161]; Companies Act 2006, ss 172, 174.

[8]Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3(4) Journal of Financial Economics 305–360. This authority addresses both managerial agency costs and conflicts associated with debt financing; it does not establish that every creditor–shareholder conflict is a conflict with directors personally.

project. A can choose between 2 proposals J and K, where J has a guaranteed return of 90 units, and K has 20% probability of returning 200 units. An economist in this case will always choose the option with the higher expected return, in this case J (90 > 40), but a director is not really incentivised to do so. If the board chooses to go with the first option (J) the creditor can recover part of their credit, but nothing goes to the directors which are probably equity holders. On the other hand, if the board pursues option (K), then in case of success everyone gets satisfied and the equity can be then compensated, but in case of failure nobody gets anything. Thus, for the directors, who are the ones making the decisions, it is not convenient to play it safe. This example is a simplification of a real-world scenario, since neither the director duties or the consequence of insolvency had been considered, however laid out very clearly where and how the tension lies during the decision-making.[9]

However, nowadays it's a well diffuse practice to allot stocks to the directors, that are usually tied to performance and/or other elements. By doing so the director became also a contractual stakeholder, and thus the agency cost is then mitigated, at least for the equity side.[10]

Economic rationale & risk allocation

When directors approve liquidity extraction to provide returns to shareholders, they reduce the cash remaining available to the company. This does not necessarily undermine financial sustainability: returning cash that exceeds the company's investment and operational needs can

[9]Author's hypothetical illustration of risk shifting; compare Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3(4) Journal of Financial Economics 305–360, section 4.1. The assumptions about debt priority, residual claims and project outcomes should be made explicit.

[10]Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3(4) Journal of Financial Economics 305–360. Equity incentives can align managerial and shareholder interests; this source does not substantiate the draft's general historical claim that agency costs have become less evident, or a reduction in creditor–shareholder conflicts.

limit the resources available for unproductive managerial expenditure.[11] However, a conflict may arise between shareholders' interest in receiving an immediate payment and creditors' interest in preserving the company's capacity to meet its obligations. The conflict becomes particularly relevant where additional borrowing finances the payout, allowing shareholders to receive cash while the company assumes further repayment obligations. Directors whose incentives are closely aligned with shareholders may face pressure to favour these immediate returns over the company's longer-term financial needs. The allocation of risk also differs between creditors: new lenders financing the transaction may negotiate terms reflecting its purpose and risks, while existing creditors may face increased exposure without obtaining additional protection. Private-equity-sponsored dividend recapitalisations illustrate this tension, as portfolio companies incur additional debt to fund distributions to their shareholders. Such transactions do not inevitably lead to financial failure, but their consequences warrant examination. A recent empirical working paper reports increased financial distress and reduced prices of pre-existing loans following the recapitalisations studied, providing evidence of potential costs to existing creditors.[12]

Thus, the agency conflict between shareholders and creditors becomes particularly relevant in the context of debt-funded distributions. While shareholders benefit from the immediate extraction of corporate value, creditors remain exposed to the company's ability to meet its outstanding obligations. Thus, dividend recapitalisations may therefore intensify this conflict by

[11]Michael C. Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers" (1986) 76(2) American Economic Review 323–329, 323–326 (the free-cash-flow rationale for payouts).

[12]Abhishek Bhardwaj, Abhinav Gupta and Sabrina T. Howell, "Capital Structure & Firm Outcomes: Evidence from Dividend Recapitalizations in Private Equity", NBER Working Paper No. 33435 (January 2025, revised April 2025). The cited findings concern the study's sampled private-equity dividend recapitalisations; they do not establish that every debt-funded payout causes distress.

combining a reduction in shareholders' residual investment with an increase in corporate leverage.[13]

Capital-maintenance rules seek to address certain aspects of this problem by restricting distributions that would improperly deplete the company's legally protected capital.[14] However, their effectiveness is less straightforward where a distribution is supported by sufficient distributable profits but financed through additional borrowing. In such circumstances, the legal permissibility of the distribution does not necessarily establish the financial sustainability of the transaction.

This distinction raises the central question of whether traditional capital-maintenance mechanisms adequately protect creditors against the risks associated with debt-funded dividends, or whether effective protection requires additional safeguards based on solvency, directors' duties and insolvency law.

Dividend Funding

The capital maintenance rules are then the battlefield for financial engineering. As a matter of fact, financial engineering is mostly based on arbitrages and workarounds, as it rejects the claim that financing choices alone do not change firm value, as expressed in the Modigliani-Miller theory. More specifically this theory states that in a frictionless environment (no tax or transaction costs) replacing equity with cheaper debt, the weighted average cost of capital (WACC) remains unchanged, since the equity risk goes up proportionately to the amount of debt coming in.[15]

[13]Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3(4) Journal of Financial Economics 305–360; Abhishek Bhardwaj, Abhinav Gupta and Sabrina T. Howell, "Capital Structure & Firm Outcomes: Evidence from Dividend Recapitalizations in Private Equity", NBER Working Paper No. 33435 (January 2025, revised April 2025).

[14]Companies Act 2006, ss 830, 831; DGCL §§154 and 170.

[15]Franco Modigliani and Merton H. Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment" (1958) 48(3) American Economic Review 261–297, especially the assumptions and Propositions I–II. The source

Dividend Recapitalisation (Debt Funding)

An interesting instrument diffused in modern finance is the Dividend Recapitalisation. This commercial practice supposes that a Company searches for debt to pay-out an extraordinary dividend to its shareholders.[16] More specifically, a company may have sufficient distributable reserves to support a dividend but lack the cash needed to pay it while also meeting its operational requirements. Borrowing can provide the necessary liquidity, subject to the applicable legal requirements and contractual restrictions.

Consider Company A, which has 20 units of cash and 20 units of distributable reserves but requires 25 units of cash to fund its operations. Without additional financing, it cannot meet those funding needs and pay the proposed dividend (of 20 units). If it borrows 27 units, its available cash increases to 47 units. It can then allocate 25 units to its operations, pay a dividend of 20 units and retain 2 units as a liquidity cushion. This example assumes that the operational expenditure does not reduce the distributable reserves available to support the dividend and disregards interest and transaction costs.[17]

Dividend recapitalisation is therefore a financing technique for providing liquidity to fund shareholder distributions, rather than an accounting device for circumventing the legal restrictions on dividends. It enables shareholders to receive a return while increasing the company's indebtedness.

supports the conditional capital-structure benchmark; it does not support the preceding characterisation of financial engineering as disregarded by economists or as rejecting that benchmark.

[16]Abhishek Bhardwaj, Abhinav Gupta and Sabrina T. Howell, "Capital Structure & Firm Outcomes: Evidence from Dividend Recapitalizations in Private Equity", NBER Working Paper No. 33435 (January 2025, revised April 2025) (definition and context of dividend recapitalisations).

[17]Author's numerical illustration, not an empirical transaction. The 2-unit residual follows from 20 + 27 − 25 − 20; the stated assumptions exclude financing costs and any reduction of available profits caused by the operational use of cash.

An alternative to traditional lending for debt funding is the use of payment in kind notes (PIK). PIK notes are a financial instrument that helps borrowers maintain short-term liquidity by capitalising interest and postponing payments. Unlike ordinary loans, which require regular cash payments, PIK (fully) notes only require the total amount including interest to be paid at the end. This protects short-term liquidity but increases the final burden and financial risk. Another alternative is the toggle PIK note, which according to contractual terms, allows one to choose which period to capitalize and which to pay in cash. Due to their flexibility, toggle PIK notes may be less risky than traditional PIK notes because the final amount can be structured accordingly to the needs of the company.[18]

From a creditor-protection perspective, PIK financing illustrates a potential limitation of traditional capital-maintenance rules. While such rules generally constrain distributions by reference to legally available profits or reserves, they do not necessarily require a comprehensive forward-looking assessment of the financial obligations arising from the borrowing used to fund those distributions. Consequently, a dividend may satisfy the applicable distribution requirements even where the associated financing creates substantial future repayment or refinancing risks.[19]

An alternative: Equity Funded dividends

Company A may raise equity through a cashbox placing involving a special purpose vehicle (SPV), which issues ordinary shares and redeemable preference shares. In a common structure, an investment bank subscribes for the SPV's preference shares using funds received from investors participating in the placing. The bank also holds ordinary shares in the SPV.

[18]Catalyst Paper Corporation filed form of First Supplemental Indenture for PIK Toggle Senior Secured Notes (2012), §3.03(c) and Annex A, para (1). This filed contractual form illustrates cash/PIK elections and payment through additional notes or increased principal. Its terms do not establish that toggle PIK is invariably less risky, or that all non-PIK loans require periodic cash interest.

[19]Companies Act 2006, ss 830, 831; DGCL §§154 and 170; compare the separate prospective assessment under Companies Act 2006, s 643.

Company A then issues its own ordinary shares to the placing investors, while the bank transfers its preference shares and the necessary ordinary shares in the SPV to Company A as non-cash consideration. Following the exchange, the SPV redeems the preference shares, allowing Company A to receive the cash raised through the placing. Where the arrangement satisfies sections 612–613 of the Companies Act 2006, including the requirement to secure at least a 90% equity holding in the SPV, merger relief removes the ordinary requirement to credit the relevant premium to the share premium account. Acquiring the preference shares alone would not necessarily satisfy these conditions.[20]

The transaction may give rise to a reserve or profit that becomes available for distribution, but merger relief does not automatically establish its distributability. The assessment must determine whether the profit is realised, taking account of linked transactions and the use of the placing proceeds. Any subsequent distribution must satisfy section 830, including the deduction of accumulated realised losses, and, for public companies, the additional net-assets restriction under section 831. Accordingly, a cash-box structure may facilitate subsequent shareholder distributions, although the availability of cash and merger relief does not itself authorise a payout.[21]

Applicable Frameworks (US, UK, EU, Italy)

Distribution limits

In corporate law, there is no universal test for determining when a distribution is permissible, as different legal systems use different indicators and impose different restrictions.

[20]Companies Act 2006, ss 610, 612, 613; ICAEW and ICAS, TECH 02/17 BL, Guidance on Realised and Distributable Profits under the Companies Act 2006 (April 2017), paras 12.1–12.3; Taylor Wimpey plc, Half Year Results for the Period Ended 4 July 2021 (4 August 2021), "Share capital". Merger relief requires the statutory equity-holding conditions; acquiring only non-equity preference shares does not establish entitlement to relief.

[21]Companies Act 2006, s 830; ICAEW and ICAS, TECH 02/17 BL, Guidance on Realised and Distributable Profits under the Companies Act 2006 (April 2017), paras 3.11 and 12.4–12.16 (including assessment of linked transactions); Micro Focus International plc, financial statements for the year ended 31 October 2019, "Reserves" (issuer disclosure of merger-reserve realisation).

In the UK, the Companies Act 2006 provides a detailed framework governing distributions, starting with their definition and scope. Section 829 defines a distribution broadly as a distribution of the company's assets to its members, whether in cash or otherwise. Subsection 2 expressly excludes certain transactions from that definition for the purposes of Part 23: (a) the issue of fully or partly paid bonus shares; (b) reductions of share capital through the release of unpaid capital or repayment of paid-up capital; (c) redemptions or purchases of own shares out of capital, including fresh-issue proceeds, or out of unrealised profits, in accordance with the relevant provisions of Part 18; and (d) distributions of assets to members during winding up. Unlike Delaware's surplus-based approach, the general UK distribution limit is determined by accumulated realised profits, less accumulated realised losses, subject to the adjustments specified in s 830. This determines the amount legally available for distribution, rather than the cash available to fund it. Additionally, public companies must satisfy the net-assets restriction under s 831: their net assets must not be less than the aggregate of called-up share capital and undistributable reserves, and the distribution must not reduce net assets below that aggregate. Subsection 4 identifies the undistributable reserves as: (a) the share-premium account; (b) the capital-redemption reserve; (c) the excess of accumulated unrealised profits not previously utilised by capitalisation over accumulated unrealised losses not previously written off through a duly made reduction or reorganisation of capital; and (d) any other reserve whose distribution is prohibited by another enactment or the company's articles.[22]

Italy's approach, in the S.p.A. framework considered here, differs from the common-law systems particularly through its mandatory legal reserve. Under Article 2433 c.c., dividends may be paid only from profits earned and resulting from regularly approved financial statements, with

[22]Companies Act 2006, ss 829, 830, 831.

the distribution decision adopted by the shareholders' meeting. Where losses have impaired share capital, profits cannot be distributed until the capital is restored or reduced accordingly.[23] Additionally, not all annual net profits are necessarily available for distribution. Under Article 2430, at least 5% must be allocated to the legal reserve until it reaches 20% of share capital. Article 2431 separately provides that amounts received as share premium cannot be distributed until the legal reserve reaches that threshold. The legal reserve therefore restricts extraction and provides an accounting buffer against losses, although it does not itself guarantee solvency or represent a separate cash fund. If diminished, it must be replenished in accordance with Article 2430.[24] Italy also permits interim dividends under the specific conditions in Article 2433-bis. These payments require authorisation in the articles, which constrains directors' ability to make them independently of the company's constitutional arrangements. They are available only to companies whose accounts are subject by law to statutory audit under the special regime prescribed for public-interest entities. The directors must approve the payment after a positive audit opinion on the preceding financial year's accounts and their approval. Interim dividends are prohibited where the latest approved accounts disclose losses relating to that or earlier financial years. Their amount cannot exceed the lower of profits earned since the preceding year-end, after required reserve allocations, and available reserves. Directors must also prepare accounting information and a report demonstrating that the company's patrimonial, economic and financial position permits the payment, obtaining the auditor's opinion on those documents.[25]

In the US, more specifically for companies incorporated in Delaware, the framework uses a different benchmark and provides flexibility through alternative dividend routes. Under DGCL

[23]Codice civile, art 2433.

[24]Codice civile, arts 2430–2431.

[25]Codice civile, art 2433-bis, especially paras 1–6.

§154, surplus is the excess of net assets over the amount legally classified as capital, with net assets calculated as total assets fewer total liabilities. Section 170 permits dividends from that surplus, subject to restrictions in the certificate of incorporation. Where no surplus exists, it also permits dividends from net profits for the current and/or preceding financial year, a route commonly described as the "nimble dividend." The distinction is important: surplus measures the excess of net assets over legal capital at a particular time, whereas net profits concern earnings during the relevant financial period. However, where losses, depreciation or other reductions have impaired capital below the amount represented by shares carrying a liquidation preference, dividends cannot be paid through the net-profits route until that deficiency is repaired. Section 173 additionally requires dividends to comply with the chapter and permits payment in cash, property or shares.[26]

Buy-backs

Share buybacks provide another mechanism for returning liquidity to shareholders, through the company's acquisition of its own shares. Although the payment takes the form of a purchase price rather than a dividend, it reduces the resources remaining available to the company. Consequently, legal systems impose restrictions on both the financing and authorisation of these transactions.

In the UK, purchases of own shares are governed by Part 18 of the Companies Act 2006. Section 690 permits a limited company to purchase its own shares, subject to the statutory requirements and any restrictions in its articles. Under s 691, the shares must be fully paid and normally paid for on purchase, with a specific exception for certain employee-share-scheme purchases. Section 692 generally requires the purchase to be financed from distributable profits or the proceeds of a fresh share issue made for that purpose, with additional rules governing any

[26]Delaware General Corporation Law (DGCL), §§154, 170(a), 173.

premium payable. Private companies may also make payments out of capital through specified statutory routes. The ordinary Chapter 5 procedure requires a directors' statement concerning the company's financial position and prospects, an auditor's report and a special resolution. Creditors may apply to the court within five weeks to challenge the resolution authorising that capital payment. Separately, s 692(1ZA) permits a limited annual capital payment, where authorised by the articles, up to the lower of £15,000 and 5% of the nominal value of fully paid share capital at the beginning of the financial year. Shareholder-authorisation requirements also distinguish between off-market and market purchases under ss 694 and 701.[27]

In Italy, Article 2357 c.c. permits an S.p.A. to purchase its own shares only within the limits of distributable profits and available reserves resulting from the latest regularly approved financial statements. Only fully paid shares may be purchased. The transaction must be authorised by the shareholders' meeting, which specifies the maximum number of shares, the minimum and maximum purchase price, and an authorisation period not exceeding eighteen months. For companies accessing the risk-capital market, the nominal value of shares acquired under these provisions cannot exceed one fifth of share capital, including shares held by subsidiaries. Shares acquired in breach of the requirements must generally be disposed of within one year; otherwise, they must be cancelled and the capital reduced accordingly. Article 2357-ter additionally suspends voting rights attached to own shares and requires the acquisition to be recorded as a corresponding reduction in equity through a negative balance-sheet item.[28]

In Delaware, DGCL §160 generally prohibits a company from purchasing or redeeming its own shares where capital is already impaired or the transaction would cause impairment. Unlike

[27]Companies Act 2006, ss 690, 691, 692, 694, 701, 714, 716, 721. Section 692(1ZA) supplies the small-capital-payment route; Chapter 5 supplies the ordinary capital-payment procedure.

[28]Codice civile, arts 2357 and 2357-ter.

the dividend rules under §170, §160 does not provide a general alternative based on current or preceding-year net profits. It does, however, permit specified acquisitions out of capital: shares carrying a preference over another class or series may qualify, or any shares where no such preferred shares remain outstanding, provided the acquired shares are retired and capital is reduced in accordance with §§243–244. The general capital-impairment restriction therefore operates alongside a specific route connecting the acquisition to a capital reduction.[29]

The comparison shows that buy-backs cannot simply be treated as dividends under another name. The UK provides distinct financing routes, including procedures for private-company payments out of capital; Italy connects ordinary purchases to distributable profits and available reserves; and Delaware applies a capital-impairment restriction with specified exceptions. For creditor protection, the relevant question is therefore both how much may be paid, and which additional safeguards accompany the route selected.

Capital Reductions

Capital reductions are particularly relevant to liquidity extraction because they can alter the amount of capital protected against shareholder payouts, reducing thus the benchmark for distribution. However, not every reduction automatically transfers resources to shareholders. A reduction may return paid-up capital, release an obligation to contribute unpaid capital, or adjust the capital figure to reflect losses already incurred. These effects must be distinguished when assessing the consequences for creditors.

In the UK, s 641 of the Companies Act 2006 provides two principal procedures. A private company limited by shares may reduce its capital through a special resolution supported by a solvency statement, while a reduction by any limited company having share capital may proceed

[29]DGCL §160(a)(1); §§243–244.

through a special resolution confirmed by the court. Under the solvency-statement procedure, each director must form the opinions required by s 643, taking account of all liabilities, including contingent and prospective liabilities. These opinions address the company's present ability to discharge its debts and, ordinarily, its ability to pay debts as they fall due during the following year. A different statutory formulation applies where winding up is intended within twelve months. Under the court procedure, qualifying creditors may object where they can demonstrate a real likelihood that the reduction would prevent payment of their claims when due. Where those creditor-protection provisions apply, the court must be satisfied that each entitled creditor has consented or that the relevant claim has been discharged, determined or secured. Additionally, the Companies (Reduction of Share Capital) Order 2008 permits reserves arising from specified reductions to be treated as realised profits, subject to relevant restrictions. A reduction can therefore facilitate a subsequent distribution as well as an immediate repayment of capital.[30]

In Italy, Article 2445 c.c. permits an S.p.A. to reduce capital through the release of shareholders from outstanding contribution obligations or through repayment of capital, within the limits imposed by Articles 2327 and 2413. The notice convening the shareholders' meeting must explain the reasons and method of the reduction. The resolution may generally be implemented only after ninety days from its registration, provided no creditor whose claim predates registration has opposed it within that period. The court may nevertheless permit implementation where it considers the risk of prejudice unfounded or the company provides suitable security. This procedure gives existing creditors an opportunity to challenge the proposed reduction before it is implemented. At EU level, Article 75 of Directive 2017/1132 similarly provides creditor

[30]Companies Act 2006, ss 641, 642, 643, 645, 646, 648; Companies (Reduction of Share Capital) Order 2008, SI 2008/1915, art 3.

safeguards for reductions of subscribed capital, subject to the exceptions in Article 76. These voluntary reductions should be distinguished from reductions addressing losses under Articles 2446–2447 c.c., which do not themselves constitute a payment to shareholders.[31]

In Delaware, DGCL §244 permits the board to reduce capital through specified methods, including reductions connected with retired shares and otherwise authorised purchases or redemptions. It also allows eligible amounts to be transferred from capital to surplus within the statutory limits. This can increase the surplus potentially available for a subsequent dividend, although the payment must still satisfy the applicable dividend requirements. Section 244(b) expressly prohibits a reduction unless the assets remaining afterwards are sufficient to pay debts for which payment has not otherwise been provided. Unlike a reduction releasing unpaid contributions in the UK or Italy, a reduction under §244 cannot release a shareholder's liability on shares that have not been fully paid.[32]

Capital reductions therefore demonstrate that the protected capital figure is not necessarily fixed throughout the company's life. Its alteration is itself regulated through different safeguards: the UK combines solvency-based and court-supervised procedures; Italy provides a waiting period and creditor opposition; and Delaware expressly conditions reductions on the sufficiency of remaining assets to meet the relevant debts. The adequacy of creditor protection must consequently be assessed by examining both the reduction procedure and any subsequent extraction it makes possible.

[31]Codice civile, arts 2327, 2413, 2445–2447; Directive (EU) 2017/1132 relating to certain aspects of company law [2017] OJ L169/46, arts 75–76. These provisions support the reduction procedure described; acquisition of own shares does not itself automatically reduce nominal share capital: see art 2357-ter and Consiglio Notarile di Milano, Massima No. 146 (17 May 2016).

[32]DGCL §§243–244, particularly §244(a)–(b).

Beyond Capital Maintenance

The applicable frameworks illustrated above establish the conditions under which distributions and other returns of capital are permitted. However, compliance with these transaction-specific requirements does not exclude the possibility of exposing creditors to financial risk. It is therefore necessary to examine the additional duties, contractual protections and remedies that operate alongside capital maintenance.

Starting with capital reductions, a significant difference concerns the procedures through which creditors can protect their position. A lawful reduction may lower the capital benchmark restricting subsequent distributions, although it does not necessarily involve an immediate transfer of cash. In Italy, Article 2445 provides a waiting period and an opportunity for qualifying creditors to oppose implementation. In the UK, the court-confirmed procedure operates alongside the solvency-statement route available to private companies. Delaware's §244 does not establish an equivalent statutory creditor-opposition procedure but requires the remaining assets to be sufficient to pay debts for which payment has not otherwise been provided. These differences identify distinct methods of protection; they do not, by themselves, establish that creditors have no effective remedy in one jurisdiction or that court approval is universally required in the others.[33]

Another issue arises where directors anticipate a substantial loss or future liability that has not yet been reflected fully in the accounts. Italian interim dividends under Article 2433-bis illustrate the importance of examining more than the amount of currently recorded profits. The provision requires accounting information and a directors' report demonstrating that the company's patrimonial, economic and financial position permits the distribution, together with the auditor's opinion. Consequently, the absence of losses in the latest approved annual accounts

[33]Codice civile, art 2445; Companies Act 2006, ss 641, 643, 645, 646; DGCL §244(b).

cannot complete the assessment. Where a material deterioration is foreseeable, the relevant questions concern its treatment in the financial information, the adequacy of the supporting assessment and the directors' conduct in approving the payment.[34]

Similar questions arise under Delaware's alternative dividend routes. Surplus measures the excess of net assets over legal capital at a particular time, while the nimble-dividend route refers to qualifying net profits for the current and/or preceding financial year. Net profits are an earnings measure, rather than a direct measure of cash available for debt repayment. A dividend supported by recent profits may reduce the resources remaining available to creditors, but it does not necessarily postpone contractual repayments or lead to financial distress. Its consequences depend on the amount distributed, the company's remaining resources and its future obligations.[35]

The surplus route also depends on valuation judgments. For instance, a patent may be valuable within the company's operations while having limited value if sold separately. That difference does not automatically establish that the asset has been overvalued, but it makes the valuation premise important, particularly when comparing going-concern value with potential recoveries in liquidation. In Klang v Smith's Food & Drug Centers, Inc., the Delaware Supreme Court recognised, in the buy-back context, that balance sheets are not conclusive indicators of surplus. Directors may revalue assets using acceptable data and methods reasonably believed to reflect present values, subject to the limits identified in the judgment.[36]

The responsibility for those judgments is qualified by reliance protections. DGCL §§172 and 141(e) protect directors who rely in good faith on corporate records and qualifying information

[34]Codice civile, art 2433-bis, paras 4–6. The discussion of foreseeable deterioration is an application of the required assessment, not an express statutory safe harbour for unrecorded losses.

[35]DGCL §§154 and 170(a).

[36]Klang v Smith's Food & Drug Centers, Inc., 702 A.2d 150 (Del. 1997), 154–156.

or expert reports. The statutory conditions include reasonable belief in the expert's competence and selection with reasonable care. An expert report therefore does not automatically remove responsibility for the decision. Section 174 separately establishes directors' liability for wilful or negligent violations of the relevant dividend and share-purchase restrictions. The interaction between liability and reliance protection is important when assessing how the law disciplines uncertain financial judgments.[37]

Directors' duties also provide a response where the specific distribution requirements have been satisfied. As discussed earlier, Sequana confirms that compliance with the UK distribution regime does not exclude the applicable duty concerning creditors' interests. Its significance here is the additional scrutiny of the decision where that duty is engaged. The ordinary duty of reasonable care, skill and diligence under s 174 also remains relevant to the decision-making process. In Italy, Article 2394 c.c. establishes directors' responsibility towards creditors for breach of obligations concerning preservation of the integrity of corporate assets. Creditors may bring the action when those assets are insufficient to satisfy their claims; establishing liability also requires connecting that insufficiency to the relevant breach. These mechanisms extend the analysis beyond the calculation of an available distribution amount.[38]

The availability of enforcement must nevertheless be distinguished from the existence of an obligation. In North American Catholic Educational Programming Foundation, Inc. v Gheewalla, the Delaware Supreme Court rejected direct creditor claims against directors for breach of fiduciary duty, including where the corporation is insolvent. However, creditors of an insolvent corporation may bring derivative claims on its behalf. Actual insolvency, rather than merely

[37]DGCL §§172 and 174; DGCL §141(e).

[38]BTI 2014 LLC v Sequana SA [2022] UKSC 25, especially [158]– [161]; Companies Act 2006, s 174; Codice civile, art 2394; Cass. civ., sez. I, 29 December 2017, no. 31204.

operating within the zone of insolvency, is the relevant condition. The duty remains owed to the corporation, and derivative recovery benefits the corporation rather than automatically compensating the individual creditor. This restriction concerns fiduciary claims and does not eliminate independently available contractual or other creditor claims.[39]

Contractual protections therefore form another part of the framework. Creditors may negotiate restrictions on shareholder payments, additional borrowing or the maintenance of specified financial ratios. Such terms can address extraction before the conditions for statutory or fiduciary remedies arise. Their protection, however, depends on the agreement's coverage, exceptions and enforcement. Existing creditors whose contracts permit the transaction may remain exposed, while lenders financing a new payout may negotiate protections reflecting its risks.[40]

Finally, certain transactions may be challenged through remedies directed at prejudicial asset transfers. In England and Wales, Insolvency Act 1986, s 423 addresses transactions at an undervalue undertaken for the specified purpose of putting assets beyond a claimant's reach or otherwise prejudicing the claimant's interests. In Italy, Article 2901 c.c. permits qualifying dispositions to be declared ineffective against the challenging creditor where its conditions are satisfied. Delaware's fraudulent-transfer legislation similarly provides avoidance and other relief, including qualifying injunctive remedies. In US bankruptcy proceedings, §548 of the Bankruptcy Code provides additional avoidance grounds, subject to its requirements, time limits and applicable

[39]North American Catholic Educational Programming Foundation, Inc. v Gheewalla, 930 A.2d 92 (Del. 2007), 99–103.

[40]North American Catholic Educational Programming Foundation, Inc. v Gheewalla, 930 A.2d 92 (Del. 2007), 99–100; Greg Nini, David C. Smith and Amir Sufi, "Creditor Control Rights, Corporate Governance, and Firm Value" (2012) 25(6) Review of Financial Studies 1713–1761; for concrete debt-incurrence, restricted-payment and lien covenants, Catalyst Paper Corporation, filed form of First Supplemental Indenture for PIK Toggle Senior Secured Notes (2012), §§10.05–10.07. Contractual restrictions depend on their definitions, exceptions and enforcement provisions.

defences. The relevance of these remedies depends on the particular transaction; satisfaction of a corporate-law distribution test does not resolve those separate inquiries.[41]

Creditor protection therefore depends on the interaction between transaction restrictions, directors' responsibility, contractual safeguards and available remedies. The next section assesses whether their combined operation adequately addresses the risks associated with liquidity extraction, particularly in terms of timing, coverage and practical enforceability.

Conclusions — Adequacy of Creditor Protections

Throughout this paper, we have analysed the circumstances in which liquidity extraction may expose creditors to risks that are not fully addressed by the applicable distribution limits. The existence of those risks does not, by itself, establish that creditor protection is inadequate. Adequacy should be assessed by considering whether the framework constrains unjustified transfers of risk to creditors while allowing legitimate shareholder payouts and commercial decisions. Creditors' priority over shareholders in liquidation remains important, but it cannot guarantee recovery where insufficient assets remain. Moreover, creditors do not constitute a uniform class: their ranking, security and contractual rights can produce substantially different levels of protection.[42]

At the same time, protecting creditors cannot require directors to prioritise the repayment preferences of every individual creditor in every corporate decision. Creditors may have different interests concerning repayment, refinancing and the continuation of the business. Imposing direct fiduciary obligations towards each of them could create conflicting demands and constrain negotiations intended to preserve corporate value. The concern identified in Gheewalla is therefore

[41]Insolvency Act 1986, s 423; Codice civile, art 2901; Delaware Code, title 6, §§1304–1308; 11 USC §548(a), (c). These are distinct causes of action with separate requirements, standing rules and defences.

[42]Insolvency Act 1986, ss 107 and 175; Codice civile, art 2741. Creditor ranking and any applicable priorities remain subject to the relevant insolvency regime.

relevant to the assessment of adequacy: protection must accommodate creditors' legitimate claims without preventing directors from exercising commercial judgment for the company's benefit.[43] This does not justify disregarding creditor interests. It supports distinguishing protection of the creditor body from an individual creditor's ability to dictate the company's decisions.

The first distinction concerns protections operating before extraction and remedies available afterwards. Distribution restrictions required financial assessments and opportunities for creditor opposition can prevent a transaction from proceeding without the applicable safeguards. These mechanisms are particularly valuable because they operate while the resources remain within the company. Subsequent liability, recovery and avoidance remedies provide a necessary response where preventive requirements have been breached, or another ground of challenge exists. However, their practical value depends on matters including standing, proof, litigation costs and the availability of assets against which recovery can be obtained. The existence of a remedy must therefore be assessed alongside the conditions under which it can be used. A framework combining prevention and subsequent enforcement provides a stronger basis for protection than reliance on either alone.[44]

The second distinction concerns accounting limits and prospective financial assessments. Profits, reserves and surplus establish important restrictions on extraction, but they do not independently determine whether the company will have sufficient liquidity to meet future obligations. This is particularly relevant to dividend recapitalisations and financing through PIK instruments, where an immediate shareholder payment may accompany obligations falling due later. Prospective assessments can address matters that a distribution ceiling does not resolve,

[43]North American Catholic Educational Programming Foundation, Inc. v Gheewalla, 930 A.2d 92 (Del. 2007), 100–103.

[44]Companies Act 2006, ss 643, 646; Codice civile, arts 2445 and 2394; DGCL §174; 11 USC §548. The comparative assessment of timing and practical enforcement is the author's evaluation of these mechanisms.

including expected cash flows, contingent liabilities and repayment needs. The UK solvency-statement procedure and the financial assessment required for Italian interim dividends illustrate how such considerations can enter the statutory framework.[45] Nevertheless, forecasts remain dependent on assumptions and available information. Neither accounting calculations nor prospective assessments eliminate uncertainty; their value lies in informing and constraining the decision through complementary methods.

The third distinction concerns generally applicable protections and individually negotiated covenants. Capital-maintenance restrictions and directors' duties provide a legal baseline whose application does not depend entirely on each creditor negotiating equivalent contractual terms, although their benefits and enforcement routes differ. Covenants can supplement that baseline by restricting shareholder payments, additional borrowing or departures from agreed financial conditions. They also demonstrate that creditors may influence corporate decisions despite lacking ordinary shareholder voting rights. However, contractual protection cannot establish adequacy for creditors collectively merely because some lenders obtain strong restrictions. Its effectiveness depends on the terms agreed, the information available and the creditor's ability to enforce them. Attention must therefore be given to existing creditors whose agreements permit the proposed extraction and who obtain no additional protection when its risks arise.[46]

The comparative analysis consequently supports evaluating each jurisdiction through the interaction of its safeguards. A creditor-opposition procedure, a solvency requirement, a fiduciary obligation and an avoidance remedy address different aspects of the problem. The absence of one mechanism does not establish an absence of protection, just as its presence does not demonstrate

[45]Companies Act 2006, s 643; Codice civile, art 2433-bis, paras 4–6.

[46]North American Catholic Educational Programming Foundation, Inc. v Gheewalla, 930 A.2d 92 (Del. 2007), 99–103; Greg Nini, David C. Smith and Amir Sufi, "Creditor Control Rights, Corporate Governance, and Firm Value" (2012) 25(6) Review of Financial Studies 1713–1761.

that every relevant risk has been addressed. The decisive questions concern coverage, timing and enforceability, including whether additional safeguards respond effectively to the limitations of the transaction-specific rules.

The research question can therefore be answered affirmatively, but with important qualifications. As a matter of legal design, capital-maintenance rules, directors' duties, contractual protections and remedies together provide a substantial framework for protecting creditors against harmful liquidity extraction. Their protection remains conditional and uneven, particularly where timely intervention depends on negotiated restrictions or subsequent enforcement. This conclusion concerns the framework's design and interaction; establishing its practical effectiveness more fully would require evidence about enforcement and recovery outcomes. The priority should be to ensure reliable financial assessment, meaningful accountability and effective access to the relevant remedies, while preserving room for justified shareholder payouts. Creditor protection is adequate to the extent that these mechanisms operate together to constrain unjustified extraction, rather than being treated as independent formalities.

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