CHAPTER 1: INTRODUCTION

I INTRODUCTION

An effective corporate insolvency law is essential if states are to maintain the confidence of investors in the state's financial system. Such a law is also essential for promoting economic stability and growth.[1] Unfortunately, such laws are lacking in Thailand and other developing countries and, at least, there is a need to reform laws to impose obligations on directors of companies approaching insolvency to consider third parties.[2] The consequences of weak insolvency laws were especially evident during the Asian Financial Crisis in 1997. Statistics published by the Central Bankruptcy Court of Thailand show that there are a large number of insolvency cases,[3] with 108 764 cases filed in the Bankruptcy Court between 1999 and 2015.[4] The total value of assets affected was about three trillion Thai Baht (THB).[5] The severity of the matter is indicated in the reports of the workload of the Central Bankruptcy Court of Thailand: between January and August 2015, there were 2418 insolvency cases involving a total of THB60 775 418 417.09 in capital;[6] and 2088 cases were still outstanding from the previous year (2014).[7] Such a plethora of insolvency cases is likely to be impacting on Thailand's economic growth as well as adversely impacting Thailand's ability to attract both Thai and foreign investors. This situation is compounded by Thailand's current economic downturn caused by the military coup of May 2014.

Boriboonsate, in his study on implications of the Asian Financial Crisis in 1997, maintains that one of the main reasons for the economic downturn and the subsequent financial crisis in Thailand and other countries in Asia was an inappropriate corporate

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[1] The UN Commission on International Trade Law (UNCITRAL), *Legislative Guide on Insolvency Law* (UN Commission, 2005), 10.

[2] See Vanessa Finch, 'The Measures of Insolvency Law' (1997) *Oxford Journal of Legal Studies* 227, 227.

[3] The insolvency cases cover both individual bankruptcy and corporate insolvency cases. However, this thesis will focus specifically on corporate insolvency.

[4] The Central Bankruptcy Court, *Statistics of Case Law During the Court Proceeding and Finishing of the Central Bankruptcy Court June 1999-2015* <http://www.cbc.coj.go.th/info.php?cid=7&pm=7>.

[5] The Thai currency compared to Australian dollar on 24 July 2016 is that one Australian dollar equals 26.11 Baht (THB)

[6] The Central Bankruptcy Court, above n 4.

[7] Ibid

governance system.[8] Similarly, Dasri argues that the main problem with respect to Thai corporate law and corporate regulations was 'the lack of good governance in many sectors, and debtors were no exception.'[9] Many debtor companies did not use the borrowed funds as they should have done; that is, the funds were not spent on a company's core business of value adding.[10] In effect, analyses of the factors involved in the financial crisis in 1997 identified that company creditors lacked effective protection,[11] particularly against insolvent trading by debtor companies.

A well-publicised case, for example, occurred in 1997. Mr Pin Chakkaphak, who had fled to the UK in 2001, was alleged by the Bank of Thailand to have misappropriated the funds of Finance One Public Company Limited (Fin One). The Thai government requested the British government to extradite Mr Pin to Thailand under the *Siamese and England BE 2454* (1891) treaty.[12] The government of Thailand filed three main allegations against Mr Pin: false reporting of credit, cheque money orders and embezzlement allegations. The claim was that Mr Pin, then the President and Chief Executive Officer of Fin One, embezzled or stole money from Fin One, to the tune of 21 million Thai Baht, by dishonestly approving uncommercial loans to subsidiary companies, namely, Ekapak Limited (Ekapak) and Consolidated Business Administration Limited (CBA), without arranging appropriate security.[13] In fact, Ekapak and CBA were plainly insolvent at that time. The Government of Thailand claimed that Mr Pin allowed Fin One to pour 'good money after bad' rather than acknowledging the reality that these two subsidiary companies were insolvent. The government was of the view that Mr Pin reasonably suspected that Ekapak and CBA were insolvent and would not be able to repay their debts to Fin One. At the hearing of

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[8] Patchareewan Boriboonsate, *Corporate Performance Criteria in Australia and Thailand: Individual Tasks and Roles of Company Directors* (Doctor of Philosophy Thesis, Curtin University, 2011), 2.

[9] Tumnong Dasri, *Policies and Practices of Corporate Restructuring in East Asia: A Case of Thailand* <http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan005378.pdf>.

[10] Ibid.

[11] Ibid.

[12] *Chakkaphak v Government of Thailand* [2001] EWHC QB 158.

[13] See also Bangkok Business Online, 'Pin Chakkaphak- King of Takeover Returns', *TID-News* (Bangkok), 2012 <http://www.thaiindexnews.com/2012/09/blog-post_1.html>; Same Varayudej, 'Company Directors' Duties under the Good Corporate Governance Systems and Lessons from the Pin Chakkaphak Case' (2002) 32(1) (March) *Thammasat Law Journal* 154, 161-163.

the matter, Mr Pin argued that it was a commercial error. Moreover, he was acting in good faith in providing the loans to Ekapak and CBA. The court, however, held that 'there had to be at least prima facie evidence of dishonesty if he was to be properly committed by the District Judge.'[14]

These 'disguised loans', where there was no reasonable probability of reimbursement, affected the financial status of Fin One.[15] Consequently, Fin One later became insolvent. The significant issue to consider is whether a holding company that is close to insolvent, should be required to consider its obligations to creditors whose interests may be detrimentally affected by the provision of funds to a subsidiary company?

The UK court held that Mr Pin was not guilty because, at that time, the law in the UK allowed a holding company to financially assist its subsidiary company.[16] Although the law in the UK does protect creditors' rights in relation to fraudulent trading, the Thai government could not prove that Mr Pin managed the company with dishonest intentions.[17] Moreover, there were no Thai laws or regulations requiring the holding company to prevent insolvent trading by its subsidiary companies when the subsidiary company was in the insolvent state.[18] In addition, the management of the company by Mr Pin with a focus on benefits to the subsidiary companies or parent company without considering the interests of creditors was not illegal under Thai law.

Many creditors suffered and themselves became insolvent as a result of the collapse. In addition, the collapse of Fin One caused incalculable damages to Thailand's economy during the Asian Financial Crisis in 1997. King claimed that after the Fin

[14] *Chakkaphak v Government of Thailand* [2001] EWHC QB 158, [20].

[15] Ibid.

[16] Ibid, [22-24]; It is noteworthy to note that s 214 of the Australian *Corporations Act 2001* (Cth) allows a holding company to provide financial benefits to a closely-held subsidiary without member approval.

[17] Ibid [52].

[18] 'Insolvent state' occurs when a company is unable to pay its debts or is bankrupt without a formal order by the bankruptcy court that the company is insolvent. In Thailand, there are only two conditions for companies: solvent and insolvent. That is, a Thai company is not regarded as insolvent if the bankruptcy court does not so find. In developed countries, such as the UK, Australia, US and Germany, companies can be in the state of insolvency or called 'insolvent companies' without a court order. Thus, the state of insolvency referred to in this thesis means the period of time or situation in which a company is factually insolvent or is unable to pay its debts before the sentence by the bankruptcy court that it is insolvent.

One collapse, the Finance Minister discovered that ‘almost all of the country’s $30 billion in foreign exchange reserves had been committed in forward contracts, while another $8 billion had been used by the central bank’s Financial Institutions Development Fund to prop up struggling finance companies.’[19]

After the 1997 Asian Financial Crisis, many proposals have been made to the Ministry of Justice to reform the Thai bankruptcy system.[20] Bankruptcy law frameworks from other countries were studied to examine the possible application. For example, the UK *Insolvency Act* 1986, the Singapore *Organization Law* and also Rehabilitation under Chapter 11 of the US law were studied to be a model for Thai bankruptcy law.[21] However, to date, a law preventing insolvent trading is still not included in any Thai law, and a company director who allows his company to trade while it is insolvent or nearing insolvency will not be personally liable for any damages affecting creditors or shareholders.

At the international level, the responsibility and liability of directors and officers of an enterprise in insolvency and pre-insolvency cases has become a key issue of concerns for international institutions, as illustrated by the work of the UN Commission on International Trade Law (UNCITRAL).[22] UNCITRAL has published *Legislative Guide on Insolvency Law* that aim to modernise and harmonise the insolvency laws of various countries.[23] The guidelines deliver ‘greater flexibility to reform a broader range of laws, especially with the benefit of time and incremental progress.’[24] Moreover, the

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[19] Michael R King, ‘Who Triggered the Asian Financial Crisis?’ (2001) 8(3) *Review of International Political Economy* 438, 441.

[20] Wisit Wisitsora-at, ‘Lessons Learned: Bankruptcy Reform in Thailand’ in *Asian Insolvency Systems: Closing the Implementation Gap* (OECD, 2007), 133.

[21] Tumnong Dasri, *Forum for Asian Insolvency Reform (Fair): Maximising Value of Nonperforming Assets*, 8 OECD and OCDE <http://www.oecd.org/daf/ca/corporategovernanceprinciples/20215534.pdf>.

[22] See *Insolvency Law: Possible Future Work,* UN GAOR, 38th sess, A/CN.9/WG.V/WP.93/Add.3 (19-23 April 2010); *Insolvency Law: Directors’ Responsibilities and Liabilities in Insolvency and Pre-Insolvency Cases*, UN GAOR, 40th sess, A/CN.9/WG.V/WP.100 (31 October – 4 November 2011); Insolvency Law: Directors’ Obligations in the Period Approaching Insolvency, UN GAOR, 41th sess, A/CN.9/WG.V/W.P.104 (30 April –4 May 2012).

[23] The UNCITRAL, *The UNCITRAL Guide: Basic Facts About the United Nations Comission on International Trade Law* (2007), 16.

[24] Susan Block-Lieb and Terence Halliday, ‘Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law’ (2006) 42(3) *Texas International Law Journal* 475, 479.

guidelines provide lengthy and nuanced commentary to persuade domestic legislatures to adopt the recommendations.[25]

At the domestic level, developed countries, such as the UK, Australia, the US and Germany have specific, though different, provisions or rules to solve the problem of insolvent trading.[26] For example, the *Insolvency Act 1986* (UK) provides wrongful trading provisions by imposing a specific duty on directors when a company is insolvent.[27] Under these provisions, a director will be liable for wrongful trading if a company's business continues after the director becomes aware that there is no reasonable prospect to avoid insolvent liquidation.[28] Similarly, the Australian *Corporation Act 2001* establishes a duty on directors that prevents insolvent trading;[29] that is, directors must prevent their company from trade or incurring debts when their company is insolvent or will become insolvent by incurring debts. This means that company directors must not be negligent or careless in conducting a company. The US imposes a fiduciary duty in the case of insolvent trading. The duty of a director to make decisions in the best interest of a company will be extended to creditors when the company is insolvent.[30] In Germany, which operates a civil law system, the *Insolvency Statute 1994* states that the board of directors must file a request in order to open proceedings not later than three weeks after the commencement of insolvency or over-indebtedness.[31]

II THESIS STATEMENT

This thesis argues that current Thai laws, as of March 2016, do not inadequately protect creditors' interests by creating a duty for company directors when a company is

[25] Ibid, 479-480.

[26] See Oscar Couwenberg and Stephen J Lubben, 'Solving Creditor Problems in The Twilight Zone: Superfluous Law and Inadequate Private Solutions' (2013) 34 *International Review of Law and Economics* 61, 64.

[27] The *Insolvency Act 1986* (UK) s 214

[28] Aydin Ozkan, Jannine Poletti-Hughes and Agnieszka Trzeciakiewicz, 'Directors' Share Dealings and Corporate Insolvencies: Evidence from the Uk' (2015) *The European Journal of Finance* 1, 4.

[29] The *Corporations Act 2001* (Cth) s 588G

[30] *Official Committee of Unsecured Creditors v Baldwin* (In re Lemington Home for the Aged), 659 F 3d 282, 290 (3rd Cir, 2011).

[31] The *Insolvency Statute 1994* (Germany) s 15a

nearing insolvency or becomes insolvent. In order to foster a good corporate governance framework with a view to maintaining and protecting Thailand's financial stability and promoting the economic growth of Thai businesses, it is necessary for Thailand to reform its corporate and insolvency laws so as to establish an effective regulatory framework for imposing duties and liabilities on company directors to protect the interests of creditors and other stakeholders. The link between financial stability and good corporate governance has been coherently articulated by Jesover and Kirkpatrick who maintain that good corporate governance – the rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders like employees and creditors – contributes to growth and financial stability by underpinning market confidence, financial market integrity and economic efficiency.[32] Furthermore, in the *UNCTRAL Legislative Guide on Insolvency Law*, it has been stated that '[g]ood corporate governance should provide incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders, as well as fostering the confidence necessary for promoting business investment and development'.[33] For the purpose of this thesis, this author principally focuses on the directors' obligation which leads to creditors' protection for insolvent trading in Thailand. Specifically, this thesis is concerned with the frameworks that will prohibit companies from trading when they are insolvent.

A report by the National Council for Peace and Order of Thailand notes that Thai laws need reform because they are out-of-date[34] to enable their application in current economic circumstances. For example, Thailand's law on bankruptcy fails to effectively protect creditors because it requires them to engage in lengthy procedures to prove their claims, which generally result in relatively small reimbursements.[35] This

[32] Fianna Jesover and Grant Kirkpatrick, 'The revised OECD principles of corporate governance and their relevance to non-OECD countries' (2005) 13(2) *Corporate Governance: An International Review* 127, 2.

[33] UNCITRAL, *UNCITRAL Legislative Guide on Insolvency Law: Part Four: Directors' Obligations in the Period Approaching Insolvency* (United Nations, New York, 2013) 3.

[34] Office of the Permanent Secretary for Defence, *Consensual Framework for Reforming Thailand in Regard to Law and Judicial Administration* (2014) 3.

[35] Florencio López-de-Silanes, Edgardo Buscaglia and Norman Loayza, 'The Politics of Legal Reform [with Comments]' (2002) 2(2) *Economia* 91, 109.

is in spite of the fact that bankrupt companies are required to be reorganised to maximise the chance that creditors will be paid,[36]

This study will be particularly concerned with Thailand's *Bankruptcy Act BE 2483 (1940)*. To assess the types of amendments to the *Act* that should be made and would be most likely to succeed in Thailand, this study will analyse the theoretical foundations of equivalent laws of various jurisdictions, considering their advantages and disadvantages and using the *UNICTRAL Legislative Guide on Insolvency Law* as a basis for comparison. The thesis also aims to advance model provisions that will help to protect the Thai business sector and creditors from the significant damage caused by insolvent trading.

III SIGNIFICANCE OF THE RESEARCH

This thesis advances the view that the Thai economy should be protected by an effective regulatory framework that provides Thai and foreign investors, creditors, minority shareholders and stock markets with the assurance that companies will be prevented from engaging in insolvent trading. The research provides legislators with law reform recommendations that, if implemented, are likely to enhance the confidence of investors in the efficiency of the securities market in Thailand because the creditors and investors will be protected from insolvent trading by debtor companies. This research will, thus, potentially benefit both Thai and foreign creditors and investors who are interested in doing business in Thailand.

IV PURPOSE OF THE RESEARCH

This research aims to investigate and critically analyse the problems arising from the lack of legislation and regulations to impose a duty on Thai company directors to prevent their companies from engaging in insolvent trading. The occurrence of corporate insolvent trading in Thailand has a significant adverse impact on the country's competitiveness and long-term economic growth. The research will examine the legal frameworks regulating corporate insolvent trading in Australia, the UK, the

[36] Tumnong Dasri, *A Successful Effort in Management of Corporate Debt Restructuring in Thailand: Lessons Learnt* (South-East Asian Central Banks Research and Training Centre (The SEACEN Centre), 2004), 2.

US and Germany and compare these with the UNCITRAL guidelines on insolvent trading. The research will focus on the strengths and weaknesses of the laws and the guidelines, then propose recommendations for the creation of legislation to prevent insolvent trading in Thailand, taking into account Thailand's business norms.

In this regard, the research will examine the following:

1. The effects on others of the lack of regulation to prevent insolvent trading in Thailand.
2. The measures in Australia, the UK, the US, Germany and the UNCITRAL guidelines which might be suitable for Thailand's regulation.
3. The necessary steps to be taken to implement reforms to Thailand's legislative framework for preventing insolvent trading.

V CORE RESEARCH QUESTIONS

1. ***How do the current Thai statutes deal with the problem of insolvent trading? Are the laws sufficiently efficient in terms of directors' personal liabilities and protection of creditors' interests?***

The corporate laws relating directly to a company director and to creditors are the *Civil and Commercial Code BE 2468* (1925), the *Public Companies Act BE 2535* (1992), the *Securities and Exchange Act BE 2535* (1992) and the *Bankruptcy Act BE 2483* (1940). These laws will be analysed and critiqued concerning issues of definition of directors, personal liabilities of directors, standard of care, and so on.

The thesis will explore why current Thai laws, whether company law, securities law or bankruptcy law, are unable to deal with the insolvent trading problem. In other words, the laws enable directors to recklessly operate their businesses without taking into account creditors' interests while the company is insolvent.

The legal obstacles to holding directors personally responsible for company debts, and adequately protecting creditors and shareholders from insolvent trading will be discussed in Chapter 3.

2. *What are the advantages and disadvantages of insolvent trading provisions under various jurisdictions?*

It comes as no surprise that there is no perfect law or provision to prevent insolvent trading. The laws or theories utilised all have pros and cons. For example, Davies argues that s 214 of the *Insolvency Act 1986* (UK) provides an advanced model of insolvency for protecting creditors' benefits.[37] Payne and Prentice claim that s 214 is the right start for determining the responsibility of directors or debtors who operate a business inappropriately and the approach is also suitable because it imposes collective liability on directors.[38] Mokal considers that s 214 creates new rights for creditors, and responsibilities and changes in relation to pre-insolvency rights for a director and a creditor.[39] Hirt argues that s 214 would alert directors to the fact that 'they have stricter obligations and face more scrutiny in situations where their company experiences financial difficulties and seems to have a preventative effect'.[40] However, Oesterle asserts that s 214 means 'the executives are less likely to take up positions on boards'.[41] Also, company directors will face risk in their management of a company's affairs which will weaken their capacity to make bold decisions to benefit their company.[42] Daniels claims that 'liability chill will deter talented individuals from accepting a nomination for board service'.[43] Mannolini asserts that directors are unfairly penalised

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[37] Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7(1) *European business organization law review* 301, 316.

[38] Jenny Payne and Dan Prentice, 'Civil Liability of Directors for Company Debts under English Law' in Ian M Ramsay (ed), *Company Directors' Liability For Insolvent Trading* (The Centre for Corporate Law and Securities Regulation and CCH Australia Limited, 2000), 209.

[39] Rizwaan J Mokal, 'An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors' Bargain' (2000) 59(2) *The Cambridge Law Journal* 335, 369.

[40] Hans C. Hirt, 'The Wrongful Trading Remedy in UK Law: Classification, Application and Practical Significance' (2004) 1(1) *European Company and Financial Law Review* 71, 103.

[41] Dale A Oesterle, 'Corporate Directors' Personal Liability for "Insolvent Trading" in Australia, "Reckless Trading" in New Zealand And "Wrong Trading" in England: a Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders' in Ian M Ramsay (ed), *Company Directors' Liability for Insolvent Trading* (The Centre for corporate Law and Securities Regulation and CCH Australia Limited 2000), 29.

[42] Ibid, 30.

[43] Ronald J Daniels, 'Must Boards Go Overboard? an Economic Analysis of The Effects of Burgeoning Statutory Liability on the Role of Directors in Corporate Governance' (1994) 24 *Canadian Business Law Journal* 229, 255.

by this provision because some failures are possible through 'errors of judgement which they make'.[44]

Thus, the thesis attempts to clarify the advantages and disadvantages of the specific insolvent trading provisions or legal theories utilised by the countries to formulate the relevant rules. Furthermore, the thesis aims to point out core components required for establishing new insolvent trading provisions under the Thai jurisdiction. A number of components, such as definition of directors, liabilities and defences, tests to verify company insolvency and director's duties in the state of insolvency will be analysed in Chapters 4 and 5.

3. *What legislative models adopted in the United Kingdom, Australia, the United States and Germany or in the UNCITRAL guidelines would be most appropriate for Thailand's reform of its current legislation in order to impose on company directors a duty to prevent insolvent trading?*

This research will critically analyse and compare the laws and related theories in the UK, Australia, the US and Germany, and the *UNCITRAL Legislative Guide on Insolvency Law* in order to determine an appropriate fit for Thailand's culture and legislative framework. The thesis extracts the core elements of insolvent trading provisions from domestic and international concepts or views and compares them with current Thai legislation in order to identify the current gaps in Thailand's insolvency trading provisions.

As already noted, the absence of specific Thai legislation to deal with the problem of trading while the company is insolvent could seriously affect Thailand's economic stability. Currently, Thai creditors and investors have no adequate protections under current laws with regard to insolvent trading. Thus, Thai government and legislature should seriously consider imposing a duty on directors to prevent insolvent trading with a view to enhancing good corporate governance and promoting certainty and

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[44] Andrew Keay, 'Wrongful Trading and the Liability of Company Directors: a Theoretical Perspective' (2005) 25(3) *Legal Studies* 431, 447.

confidence for investors in the Thai financial system and, thereby, strengthen the country's economic growth.

This thesis proposes a model for introducing insolvent trading provisions for Thailand in order to prevent the problems caused by directors negligently or carelessly enabling a company to trade when it is insolvent. The insolvent trading provisions proposed would shield creditors' interests and the business sectors from the meltdown of Thai companies as happened during the 1997 Asian Financial Crisis. Directors' personal liabilities, defences and remedies will be suggested in Chapter 4.

In addition to recommending provisions for insolvent trading this thesis considers how current Thai laws should be reformed. As mentioned, four Thai laws relate directly to the insolvent trading problem. The research will make recommendations for amendments to relevant Thai laws in order to resolve the problem of insolvent trading which occurs whether it involves a private or public company under the Thai jurisdiction.

VI RESEARCH METHODOLOGY

The research methodology for this thesis is a combination of doctrinal legal analysis and comparative legal research. Doctrinal analysis is the accepted methodology in the discipline of law[45] and the classic approach in legal scholarship.[46] Doctrinal analysis allows researchers to appraise and value legal views as to whether there is a reasonable justification for laws, or to study the implications of rules for application in future cases.[47] Doctrinal analysis can also be utilised to identify vagueness in legal reasoning, disclose discrepancy among cases and uncover dissimilarity.[48]

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[45] Terry Huchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17 *Deakin Law Review* 83, 102.

[46] Emerson H Tiller and Frank B Cross, 'What is Legal Doctrine?' (Northwestern Public Law Research Paper No 05-06, 2006) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=730284>.

[47] Ibid.

[48] Richard A Posner, 'The Present Situation in Legal Scholarship' (1981) 90(5) *Yale Law Journal* 1113, 1113.

The comparative approach is employed to examine the differences of legal systems, to find the developments and trends in legal systems, and clarify and assess differences,[49] including advantages and disadvantages. The findings from comparative research can help identify efficient forms when developing or reforming legal process.[50] This methodology is the most common measure utilised for comparing laws across jurisdictions with different legal systems.[51] Reitz argues that unequivocal comparisons of laws can increase an understanding of laws. 'Foreign law scholars could thus help comparative law "bring home the bacon" by employing explicit comparison.'[52]

Utilising both approaches, this thesis will compare and contrast specific provisions and explore advantages and disadvantages of various relevant laws and the *UNCITRAL Legislative Guide on Insolvency Law* with the aim of establishing a model law for imposing duties and liabilities on company directors to protect the interests of creditors and other stakeholders in the Thai jurisdiction by preventing insolvent trading.

The research utilises primary and secondary sources. Primary sources comprise laws, regulations, case law and rules. Secondary sources are textbooks, journal articles, reports, legislative histories, news and websites. The laws studied in this thesis are from four jurisdictions: three belonging to common law countries, Australia, the UK and the US and one from a civil law country, Germany.

The US jurisdiction was chosen because of its significant international status;[53] in terms of its GDP, the US has economic superpower status.[54] The decisions of both state and federal courts are examined in this thesis.

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[49] Anthony Ogus, 'Competition Between National Legal Systems: A Contribution of Economic Analysis to Comparative Law' (1999) 48(2) *International and Comparative Law Quarterly* 405, 405.

[50] Adilah Abd Razak, 'Understanding Legal Research' (2009) 4 *Integration & Dissemination* 19, 21.

[51] Ibid.

[52] John C Reitz, 'How to do Comparative Law' (1998) 46(4) *The American Journal of Comparative Law* 617, 620.

[53] Azeem Shaukat, *Top 10 Most Influential and Powerful Countries of the World* (21 June 2013) Inspirich <http://inspirich.com/top-10-most-influential-and-powerful-countries-of-the-world/>.

[54] Kurt Badenhausen, 'US Slides Again as Denmark Tops Forbes' Best Countries for Business' *Forbes/Business* (online), 17 December 2014

The UK is a similarly economically powerful jurisdiction internationally.[55] In addition, the UK bankruptcy legislation provided the original model for the Thai bankruptcy law.[56] The UK has been concerned about fraudulent trading since 1948 when such practices were criminalised by s 338 of the *Companies Act 1948*.[57] However, the specific provisions to prevent insolvent trading were first introduced in s 214 of the *Insolvency Act 1986*, which imposes a duty on directors when a company is insolvent.

Although Australia originally adopted the concept of fraudulent and wrongful trading from the UK, its insolvent trading provisions in s588G of the *Corporation Act* (Cth) are currently clearer and more explicit than the UK ones. There are indeed pros and cons to Australia's insolvent trading provisions which are useful to evaluate in the light of possible reforms to Thailand's current laws.

German corporate laws were researched in this thesis[58] to identify how they determine the duty of directors when a company becomes over indebted or illiquid.[59] Like Thailand, Germany has a civil law system. German law also significantly influenced the provisions in Thailand's main corporate law, the *Civil and Commercial Code*.[60]

At the international level, the *Legislative Guide on Insolvency Law* provided by the UNCITRAL was examined and compared with the provisions in the laws of the selected countries.

VII LIMITATIONS OF THE STUDY

The thesis examined the provisions relating to insolvent trading from four countries for comparative purposes. The selected countries were the three common law countries

<http://www.forbes.com/sites/kurtbadenhausen/2014/12/17/u-s-slides-again-as-denmark-tops-forbes-best-countries-for-business/>.

[55] Shaukat, above n 53.

[56] Vicha Mahakhun, *Explanation of Bankruptcy and Rehabilitation of Debtors* (Nitibannagarn, 2010), 2.

[57] Fraudulent trading is currently an offence under s 993 of the *Companies Act 2006* (UK).

[58] French law is not researched in this thesis even though some parts of the Thai *Civil and Commercial Code* was originally influenced by France because of the limited literature on the French law published in English, particularly on laws concerning insolvent trading issues.

[59] The *Insolvency Statute 1994* (Germany) s 15a.

[60] Somyot Chueathai, *Explanation of Civil Law: General Principle 1* (Winyuchon Co, 15th ed, 2008), 30.

of the UK, Australia and the US. A law of a civil law country, Germany, was also examined. However, the English literature on this jurisdiction was limited because the researcher does not read or speak German. Therefore, the range of the English literature on German corporate laws and the decisions of German courts accessed was limited. The literature obtained, nevertheless, was sufficient to achieve the goal of comparison.

Another important limitation of the study was that the literature on Thailand rarely mentions directly the problem of insolvent trading. In other words, there are not many theses and articles written about the issue of insolvent trading in the country. One reason is probably that there is no specific law to deal with insolvent trading. Therefore, this issue may not have caught the attention of scholars. Yet this thesis has shown that the general current provisions and laws there are ineffective and therefore reform is necessary to prevent insolvent trading in Thailand.

A further possible limitation of the thesis is that no qualitative research was conducted. While there may be some benefit in interviews, for example, interviewing judges, academics and other experts, it is suggested that the doctrinal legal analysis and the comparative legal research methods adopted for this research have proved adequate to answer the research questions outlined. It is also the case that what has been gleaned from this methodology is supported by the literature written by judges and scholars on the topic.

VIII DEFINITIONS OF TERM IN THE THESIS

There are a number of key terms that require an explanation in the context of this thesis.[61]

1. 'On the brink of insolvency', 'on the verge of insolvency', 'in the vicinity of insolvency', and 'in the zone of insolvency' mean some period of time when solvent firms are barely solvent, or very near to insolvency.

[61] All definitions in this part originated from the researcher. However, these terms are generally used in many contexts

2. ‘Reorganisation’ means the administration is provided for a company which is or becomes insolvent to have an opportunity to continue its business for a better outcome rather than going into liquidation or winding up. This administration can be run by a receiver, an administrator or a liquidator.

3. ‘State of insolvency’ or ‘insolvent state’ means the time which a company is unable to pay its debts or is bankrupt whether an application of commencement of insolvency proceedings has been made.

It is worthy to note that the meanings of ‘insolvent state' and ‘zone of insolvency' are different. When a company is in the insolvent state means that a company is already insolvent, irrespective of whether an application of commencement of insolvency proceedings has been made. However, if a company is in the zone of insolvency, it means that a company is nearing or approaching insolvent but it is not insolvent yet

IX STRUCTURE OF THE THESIS

This introductory chapter provides an overview of Thailand’s insolvent trading problems and how they negatively impact the country’s financial markets and economic growth. The Chapter also provides a statement of thesis arguments, the purpose of the research, the aims of the thesis, the core research questions and the purpose and significance of the research, and the methodology applied. Subsequent chapters of the thesis intended to achieve the stated aims are:

Chapter 2 explores the historical background of corporate laws under the Thai jurisdiction. In addition, the state agencies, which regulate private and public companies, are discussed. Chapter 2 aims to identify how Thai laws and state agencies influence the insolvent trading problem.

Chapter 3 examines the problems with current Thai corporate and bankruptcy laws. The chapter responds to a number of questions; for example: why is it that the current Thai statutes do not effectively protect creditors’ interests and business sectors from insolvent trading by directors of debtor companies? What elements in Thai laws require reform to prevent insolvent trading by company directors? How does the

absence of specific provisions affect the company, creditors, shareholders and third parties? And, what are the liabilities of directors for failure to prevent insolvent trading? Chapter 3 reveals six major obstacles under current Thai law to the effective protection of creditors' interests.

Chapter 4 examines the historical background and rationale for imposing a duty on company directors to prevent insolvent trading in four developed countries and the *UNCITRAL Legislative Guide on Insolvency Law: Part four: Directors' Obligations in the Period Approaching Insolvency*. The chapter focuses on how the laws and a common theory under the various jurisdictions and the UNCITRAL guidelines deal with the insolvent trading problem, particularly in light of the problems identified in Chapter 3.

The chapter also identifies the advantages and disadvantages of the provisions and theories utilised by the four jurisdictions examined. The resolution of insolvent trading from developed countries and the UNCITRAL legislative guide can be classified into four parts: (i) directors' definition, (ii) specific duties to prevent insolvent trading, (iii) liabilities, remedies and defences, and (iv) reorganisation.

Chapter 5 analyses a significant problem regarding the timing at which the duty of directors to prevent insolvent trading should arise: the absence of a state of insolvency under the Thai jurisdiction. This Chapter explains and evaluates the timing of directors' duties when companies are in insolvent states as well as considering Thai insolvent presumptions. The chapter also advances suggestions concerning at which time directors' duties to prevent insolvent trading of companies in Thailand to commence.

Chapter 6 begins with a discussion of the reasons why Thailand needs to reform its laws concerning insolvency trading and identifies the barriers to bringing about such reform. Building on the analysis discussed in Chapters 3 to Chapter 5, this chapter proposes model insolvent trading provisions for the Thai corporation legislative framework, and suggests ways for achieving the proposed reforms.

Finally, Chapter 7 synthesises the findings of this thesis by drawing together the conclusions on each of the research questions and summarising the recommendations for reform of Thai corporate and insolvency laws with a view to introducing an effective regulatory framework that imposes duties and liabilities on company directors that protect the interests of creditors and other stakeholders by avoiding trading whilst the company is insolvent or near to insolvency.

CHAPTER 2: THAI CORPORATE REGULATORY SYSTEM

I INTRODUCTION

As explained in Chapter 1, insolvent trading by company directors has been a major problem in Thailand for many years. It was particularly noticeable during the Asian Financial Crisis of 1997 and 1998, when many major Thai corporations, such as Fin One, the largest Thai finance company at the time, collapsed in insolvency.[62] However, as of 1 March 2016, Thailand still does not have specific legislative provisions to deal with companies trading while insolvent. Also, the Thai Parliament has so far made no efforts to reform the corporate and bankruptcy laws with a view to imposing obligations on company directors to prevent insolvent trading.

Currently, in the Thai jurisdiction, a number of statutes would need to be considered if insolvent trading by private and public companies is to be prohibited. The statutes are: the *Civil and Commercial Code BE 2468 (1925)* ('*CCC*'), the *Public Limited Companies Act BE 2535 (1992) ('PLC (1992)')*, the *Securities and Exchange Act BE 2535 (1992) ('SEA')* and the *Bankruptcy Act BE 2483 (1940)*.

Private and public companies registered in accordance with the *CCC* or the *PLC*, are considered separate legal entities distinct from their shareholders.[63] A legal entity, a so-called 'juristic person' under Thai company laws[64] has rights and duties defined by law: it has the ability to possess properties or assets; it can enter into contracts; be sued or, as a creditor, sue a person or a company who causes damage to a juristic person. In effect, a registered company has abilities, rights and duties similar to a natural person.

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[62] David Liebhold, 'Thailand's Scapegoat? Battling Extradition Over Charges of Embezzlement, a Financier Says He's the Fall Guy for the 1997 Financial Crash' (1999) 154(25) [27 Dec] *Time* (online) <http://edition.cnn.com/ASIANOW/time/magazine/99/1227/thailand.finance.html>.

[63] The *CCC* s 1015 states: 'A partnership or company, upon registration being made according to the provisions of this Title, continues a juristic person distinct from the partners or shareholders of whom it is composed'; The *PLC* s 41 similarly provides: 'A company registered under this Act shall be a juristic person as from the date of acceptance of registration by the Registrar.'

[64] Companies registered in Thailand can be divided into two types: private limited company or public limited company. A public company can be further separated into a public company that is not registered on the Thai securities and exchange market, or a public company that is registered (listed public company) under the *Securities and Exchange Act BE 2535* (1992) and offers shares to the public or other persons.

However, a registered company has no mind or body of its own.[65] Therefore, unlike an individual, companies do not have all the rights and duties of a natural person, such as the right to marry, adopt a child, or vote. A company's rights and powers are conferred by the law, its object is provided by or defined in the law, regulation or a constitutive act.[66] Consequently, the directing mind and will of a company must be expressed by directors or senior managers.[67]

A company's authority is controlled by the company's board of directors which has a broad range of powers for managing the company. The board of directors has liabilities and duties as provided by Thai legislation, but such legislation is currently ineffective in preventing a company from detrimentally affecting their creditors' interests, particularly in the period approaching insolvency, or when it is in an insolvent state. This chapter discusses the regulations that deal with the problem of insolvent trading, the state agencies charged with controlling or regulating private and public companies, and the process by which Thai laws could intervene in circumstances where insolvent trading is suspected.

Before examining the specific problems relating to insolvent trading in Thailand, it is necessary to explain how companies and their directors are regulated and how many of the problems being experienced are directly related to how the Thai legal system

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[65] In *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* (1915) AC 705 280, [283], Lord Haldane declared: [A] corporation is an abstraction. It has no mind of its own any more than it has a body of its own; its active and directing will must consequently be sought in the person somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation … If Mr Lennard was the directing mind of the company, then his action must, unless a corporation is not to be liable at all, have been an action which was the action of the company itself.

[66] The *CCC* (Thailand) ss 66 and 67 state that:

'Section 66. A juristic person has rights and duties in conformity with the provisions of this Code or of other law within the scope of its power and duties, or its object as provided by or defined in the law, regulation or constitutive act.

'Section 67. Subject to Section 66, a juristic person enjoys the same rights and is subject to the same duties as a natural person, except those which, by reason of their nature, maybe enjoyed or incurred only by a natural person.'

The *PLC* s 42 provides that: 'The company has the power to carry out the activities within the scope of its objectives and, unless the articles of association provide otherwise, such power shall include the power to: …

[67] *CCC* ss 70 and 1144 and the *PLC* ss 67 and 97.

operates. Thailand is a civil law country.[68] Its laws were originally influenced by the Roman law system and by the legal practices of Germany and France, which are also civil law jurisdictions. More recently, Thai laws have been influenced by common law systems, such as those of the UK and the US.[69] Thailand has therefore adopted law concepts from civil law countries and common law systems. The following section explains the background to the Thai corporate law framework in more detail.

II Historical Background of Corporate Laws

A *The Civil and Commercial Code*

The main Thai corporate law, regulating private limited companies and imposing duties on directors, is the *CCC*. The drafting committee for the *CCC* was appointed in BE 2451 (1908) at the time of Rama V,[70] but the first draft was produced during the reign of Rama VI in BE 2466 (1923). The Thai government employed the assistance of French consultants.[71] The first *CCC* comprised two books:[72] Book I held the general provisions; and Book II provided obligations.

This original *CCC* was enforced for two years but repealed and replaced in BE 2468 (1925).[73] Chueathai explains that the main reason for the repeal was to change the *CCC* from its French law concepts to those of German law concepts.[74] Although both jurisdictions are civil law jurisdictions, they differ in some respects. For example, the French Civil Code does not have general principles of law while the German one does. Moreover, the German civil code separates obligation and property but the French law does not.[75]

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[68] Komkrit Vatanasathie, *Introduction to Law* (Bunditthai, 7th ed, 2012), 56.

[69] Ibid, 56-61.

[70] Manit Jumpa, Chitaporn Pisolyabutra Tovisetkul and Kantima Changtum, *Introduction to Law* (Nititham Co, 7th ed, 2013) 64.

[71] Chueathai, above n 60, 30.

[72] Vatanasathie, above n 68, 61.

[73] Chueathai, above n 60, 30.

[74] Ibid.

[75] Ibid 30-31.

Since its origins, the *CCC* has been reformed and developed many times.[76] Khuansamakhom argues that it is important to understand how the *CCC* has been influenced by foreign laws. For instance, contract law in Book III of *CCC* derives from the legal concepts of France, Germany and Switzerland, and the laws concerning sales, bills, agency, partnership and companies were influenced by English law. Only Books V and VI of *CCC*, on family and succession laws, have adopted the principles of ancient Thai law.[77]

Companies' and directors' duties are specified in Book III of the *CCC*. Books I, II, and III were enacted in BE 2468 (1925). However, after its promulgation, Book III was broadly criticised and, consequently, extensively amended. In BE 2472 (1929), the new Book III was declared and entered into force,[78] although continuously amended to adjust to economic changes.[79]

Book III of the *CCC* contains 23 titles. Directors and companies are specified in title XXII, with 261 sections which apply to a company and director. The duties of directors also relate to the agency principle as defined in title XV of Book III.

However, although the *CCC*, and especially Book III, has been amended several times, it does not contain any provision that directly imposes a duty on directors to take action to prevent insolvent trading. Out of 151 sections of the *CCC* that deal with limited companies,[80] there are no legal principles or rules that deal with how a company should trade when it is insolvent or close to insolvency. In addition, there are a number of weaknesses or loopholes in the *CCC* which may contribute to the insolvent trading

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[76] See Office of the Council of State, <http://www.krisdika.go.th/wps/portal/general>. There are currently six books:

- Book I General principles
- Book II Obligations
- Book III Specific contracts
- Book IV Property
- Book V Family
- Book VI Succession

[77] Direk Khuansamakhom, *Introduction to Law* (Winyuchon Publication House, 9th ed, 2014), 64-65.

[78] Chueathai, above n 60, 34.

[79] See Office of the Council of State, above n 76. For eg, potentially relevant legislative amendments of the *CCC* were made in BE 2477 (1934) (No. 2), BE 2496 (1953) (No. 7) and BE 2521 (1978) (No. 9).

[80] The *CCC* ss 1096-1246.

problem. For instance, there is no definition of a 'director', and very little reference to what creates directors' liabilities. Problems with the *CCC* will be analysed in more detail in the next chapter.

B *The Public Limited Companies Act*

The first Thai law specifically regulating public companies (listed and non-listed) was the *PLC (1978)* which was approved by the National Legislative Assembly and came into effect on 6 October 1978.[81] *PLC (1978)* had 252 sections and was principally enacted because *CCC* Book III, title XXII failed to provide effective corporate governance rules to protect shareholders' rights and interests. Moreover, the *CCC* did not provide shareholders with adequate power to closely manage the company leading to many problems for the Thai business sector.[82]

One of the aims of the *PLC (1978)* was to encourage the establishment of large companies; large being specified as a public company of at least 100 shareholders. However, Setsathian argues that the Act did not achieve its goal because only around 20 large companies had been established as public companies even ten years after its enactment.[83] Setsathian claims that the main failures of the Act were that it imposed a number of onerous limitations and provided excessive powers to management. Therefore, very few people were interested in setting up or transforming a business into a public company.[84]

It is not surprising, therefore, that the *PLC (1978)* was repealed and replaced in BE 2535 by the *PLC (1992)*.[85] Like the *PLC (1978)*, the *PLC (1992)* aimed to promote the creation of public companies. Although the new Act was minus the major defects of

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[81] *The Public Limited Companies Act*, BE 2521 (Thailand) 24 December 1978, Government Gazette, Vol 95, Part 149. See also Sahas Singhaviriya, *Explanation of the Public Limited Company* (Nitibannagarn, 2010) 1.

[82] Ibid.

[83] Phiset Setsathian, *The Law Principles of Public Companies* (ChulaPress, 2014) 1.

[84] Ibid 2.

[85] The *Public Limited Companies Act*, BE 2535 (Thailand) 8 April 1992, Government Gazette Vol.109, Part 43.

the *PLC (1978)* it has, nevertheless, been amended twice: BE 2544 (2001) (No. 2) and BE 2551 (2008) (No. 3).

The *PLC* is a special law (*lex specialis*) which specifically governs public companies. Where its provisions fail to cover certain matters in corporate law, then the *CCC*, which is a general law (*lex generalis*), will apply (*lex specialis derogat legi generali*).

The *PLC (1992)* currently consists of 17 chapters and contains 225 sections. Chapter VI deals with the duties of the boards of directors in managing a public company,[86] but not in terms of protecting creditors' interests when the company is insolvent or nearing insolvency. Another significant problem with *PLC (1992)* is the ambiguity of the standard of care relating to a company director's duty under s 85.[87] In practice, Thai courts have to use their discretion in interpreting this section on a case-by-case basis.[88] In addition, there are a number of problems that relate to preventing insolvent trading under the *PLC*. For example, it is unclear whether a director of a company is personally liable for loss or damage as a result of a debt incurred by the company at the time when it is insolvent or becomes insolvent by incurring that debt. These problematic issues with *PLC (1992)* will be analysed in detail in Chapter 3.

C *The Securities and Exchange Act*

All Thai listed companies are required to operate their business according to the securities and exchange law. The *Securities and Exchange Act* ('*SEA*') was first published in BE 2535 (1992). Singhaviriya explains that the Act was passed mainly because, at that time, Thailand did not have effective defensive measures to protect

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[86] *PLC 1992* ss 67-97.

[87] Ibid s 85 para 1 states: 'In conducting the business of the company, the directors shall comply with all laws, the objects and the articles of association of the company, and the resolutions of the shareholder meetings in good faith and with care to preserve the interests of the company.'

[88] Varayudej, above n 13, 159.

investors. Also there were problems caused by the overlapping responsibilities of government departments.[89]

SEA has been amended three times since publication: in BE 2542 (1999), BE 2546 (2003) and BE 2551 (2008).[90] The current version of the *SEA* contains 13 chapters[91] and 344 provisions.

The main chapter which relates directly to duties of listed company directors is Chapter III. Division I of that chapter deals with directors and executives, and division II outlines the duties of care and loyalty, and the responsibilities of directors and executives.

However, the Thai SEA law still has some problems to prevent insolvent trading and to protect creditors' interests during the stage of insolvency. For instance, that Act does not include specific duties for directors of a listed company that is insolvent or any specific liabilities for company directors who carry on trading when insolvent. These problematic issues pursuant to the *SEA* will be considered in detail in Chapter 3.

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[89] Sahas Singhaviriya, *Knowledge of the Securities and Exchange Act B.E. 2535, (No. 2) B.E. 2542, (No. 3) B.E. 2546, (No. 4) B.E. 2551 and the Derivatives Act B.E. 2546* (Nititham Publishing House, 5th ed, 2009) 1.

[90] See Office of the Council of State, above n 76.

[91] The 13 chapters of the SEA are:

Chapter I Supervision of Securities and Exchange
Chapter II Issuance of Securities
Chapter III Public Offering of Securities
Chapter IV Securities Business
Chapter V Securities Exchange
Chapter VI Over-the-Counter Center and Futures and Options Center
Chapter VII Institutions Related to Securities Business
Chapter VIII Unfair Securities Trading Practices and the Acquisition of Securities for Business Take-Overs
Chapter IX Appellate Committee
Chapter X Supervision and Control
Chapter XI Competent Officer
Chapter XII Penal Provisions
Chapter XIII Transitional Provisions

D *The Bankruptcy Act*

The bankruptcy law of Thailand is an economic law which has as its primary goal to maintain the economic security of the country.[92] That is, as Supanit explains, a bankruptcy law has three principle objectives:[93] first, to preserve fairness among creditors by apportioning a debtor's assets; second, to release debtors or free them from obligations or debts as soon as possible and provide them with the option of rebuilding their business opportunities; and third, to protect the public from an insolvent person who creates damage by endlessly incurring debts.[94]

Teeravejparakul adds that a bankruptcy law has a special characteristic because it simultaneously contains substantive and procedural law, including criminal penalties for punishing debtors and creditors who act dishonestly. Therefore, the bankruptcy law is concerned with public order and generally gives benefits to debtors, creditors and people in that society.[95]

Under Thai law the notion of bankruptcy is included as a part of the law concerning loan agreements. It was enacted in the Ayudhya era in BE 2192 (1649)[96] and contained cruel sanctions for an insolvent person. For example, an insolvent debtor was punished by being immersed in water before being required to pay debts.[97] Later, the law was reformed and those sanctions were removed in BE 2434 (1891).

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[92] Sutee Supanit, *Principle of Bankruptcy and Rehabilitation Law* (Winyuchon Co.,Ltd, 2013), 17.

[93] Ibid 18.

[94] Ibid; See also Manfred Balz, 'Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law' (1997) 23 *Brooklyn Journal of International Law* 167, 171. Balz argues that '[t]he role of insolvency law is to organize collective action in such a way that the value of the debtor's assets will be maximized and everyone involved will be better off than without such action; in other words, to collectivize and rationalize debt collection.'; Jenny Clift, 'Developing an International Regime For Transnational Corporations: The Importance of Insolvency Law to Sustainable Recovery and Development' (2011) 20(1) *United Nations* 117, 118. Clift claims that '[a]t its most basic, insolvency law might be characterized as a debt collection mechanism, preserving and marshalling assets for distribution to creditors.'

[95] Kamon Teeravejparakul, *Bankruptcy Law and Business Rehabilitation* (Krungsiam Publishing Co, 2013), 4.

[96] Ibid 1.

[97] Ibid.

In the reign of King Rama V (BE 2451) (1908), the first formal *Bankruptcy Act* was promulgated using the bankruptcy law of other countries as models, but it was passed with some urgency and contained only eight provisions. It has been amended twice since, in BE 2470 (1927) and BE 2474 (1931) before being repealed and replaced by the *Bankruptcy Act BE 2483* (1940).[98]

The *Bankruptcy Act BE 2483* (1940) was created using concepts contained in the English *Bankruptcy Act 1914*, even though that English Act was repealed and replaced by the *Insolvency Act 1986*.[99] The *Bankruptcy Act BE 2483* is still current, but it has been amended seven times: BE 2511 (1968) (No. 2), BE 2526 (1983) (No.3), BE 2541 (1998) (No. 4), BE 2542 (1999) (No. 5), BE 2543 (2000) (No.6), BE 2547 (2004) (No. 7) and 2558 (2015) (No. 8).[100] The current Thai Bankruptcy Act contains 181 sections and eight chapters.[101]

Khunkeaw explains that a bankruptcy case, which is what the *Bankruptcy Act BE 2483* deals with, is a legal proceeding which enables the official receiver to collect all debtors' assets and divide them among all creditors using the *pari passu* principle.[102] When a company is sued, and if there are reasonable grounds to believe that the company is insolvent, the court has an option to protect the creditors' interests by using a measure called a 'receivership order'. This order is of two types: temporary receivership[103] and absolute receivership.[104] Both receivership orders shift the duties

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[98] Ibid.

[99] Auen Khunkeaw, *Bankruptcy Law* (Krung Siam Publishing Co.,Ltd., 12th ed, 2015), 1.

[100] See Office of the Council of State, above n 76.

[101] Chapter I Proceedings from a bankruptcy petition to a discharge from bankruptcy
Chapter II Proceedings in case of death of the debtor
Chapter III Proceedings in case of the debtor with the status as an ordinary partnership, a limited partnership, a limited company or any other juristic person
Chapter IV Methods for management of the debtor's property
Chapter V Receiver
Chapter VI Court's powers and bankruptcy proceedings
Chapter VII Inquiries and penalties
Chapter VIII Miscellaneous provisions

[102] Khunkeaw, above n 99, 1.

[103] *The Bankruptcy Act BE 2483* (Thailand) s 17

[104] *The Bankruptcy Act BE 2483 (Thailand)* s 14.

of directors to an official receiver. Thus, the receiver takes possession of and controls all the debtor's estates.

However, a company can be in an insolvent state before the Thai bankruptcy courts formally declare that the company is insolvent. There are no provisions in the *Bankruptcy Act BE 2483* which impose special duties on directors or impose liability on company directors who recklessly or negligently manage their business while the company is insolvent. This means that the current Thai bankruptcy law cannot protect the creditors of insolvent companies before such companies are formally declared bankrupt by the court.

Because of the absence of specific provisions to deal with insolvent trading, company creditors can be at risk without any proper protection from the law. In addition, directors can avoid liabilities even though they are not exercising their duties properly. Hence, it is necessary for Thailand to have specific provisions to prevent insolvent trading and to protect creditors' interests.

III STATE AGENCIES REGULATING COMPANIES

In Thailand, three state agencies are responsible for the control of juristic persons from the process of setting up a company until the end of the company's life.

A *Department of Business Development*

On 3 October 2002, as a result of the enactment of the *Organization of State Administration Act (*No. 5*) BE 2545 (2002)* and the *Act Amending Ministry, Sub-Ministry and Department BE 2545 (2002)*, the then Department of Commercial Registration changed its name to The Department of Business Development. The outcome of the change led to improvement in the Department regarding roles, missions and organisational structure.[105]

[105] Department of Business Development, *Department's History,* Ministry of Commerce <http://www.dbd.go.th/ewt_news.php?nid=1>.

A primary duty of the Department of Business Development is the registration of companies. All companies, whether private or public, must be registered with the Department before being able to start its business. In order to establish a private company, at least three people must, together, sign a Memorandum. The company director must then register the company within three months of the signing to establish the company.[106] To set up a public company, there must be at least 15 shareholders and at least five people on the board of directors, of which at least half of the directors must have registered addresses in Thailand, as stipulated by the *PLC (1992)*.[107]

A public company can be established in one of these ways: by registering the establishment of a company or by transforming a private company to a public limited company.[108] In regard to the registration procedure, it is similar to the set-up of a private company.

The roles and duties of the registrar are stated in the *CCC*[109] and, similarly, in the *Business Registration Act BE 2499 (1956),* which states, in section 14:

> The Registrar of Businesses shall, upon receipt of the application for registration and considering it duly compliant with the Act, Ministerial Regulations and Notifications issued under this Act, effect the registration and issue the applicant with a business registration certificate.

Moreover, the registrar has the power to give an order summoning an operator of a business for the purpose of inquiring into the facts related to the registration and to inspect the place of execution according to section 17.[110]

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[106] Department of Business Development, *Company Limited Registration* Ministry of Commerce <http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3966&filename=index>

[107] Department of Business Development, *Public Limited Registration* Ministry of Commerce <http://www.dbd.go.th/dbdweb_en/ewt_news.php?nid=3965&filename=index>

[108] Ibid.

[109] The *Civil and Commercial Code* (Thailand) ss 1015 and 1111.

[110] The *Business Registration Act BE 2499 (1956)* s 17 provides that: 'The Registrar of Businesses shall have the power to give an order summoning an operator of a business for inquiries into facts related to the registration and the Registrar of Businesses or competent officials shall have the power to enter, during office hours, offices of an operator of a business for the purpose of inspection to ensure the execution of this Act. An operator of a business must reasonably provide assistance to the Registrar of Businesses or competent officials.'

In terms of a public company, the *PLC (1992)* defines the concept of 'registrar' in section 4.[111] The law also specifies duties of the registrar for the public company in various sections, such as the duty to register any statement required in the *PLC (1992)*[112] or duty to keep corporate documents.[113]

However, the registrar of both private and public companies has no duty to prove the facts specified in an application for registration regarding whether they are accurate or not. Thus, it seems likely that Thai registrars have a duty only to check the completeness of the application's documents at registration. The corporate laws also impose no duties on the registrar if a registered company is in a poor financial situation. Thus, it can be concluded that the role and duties of Thai registrars are mainly to work on the documents rather than verify the accuracy of the information in the application.

In other words, both private and public companies must be registered with the Department of Business Development but the department has no duty to control or manage the company when it is on the verge of insolvency or is insolvent; the insolvent trading problem, is, in fact, not directly related to the Department of Business Development.

B *The Securities and Exchange Commission*

The Securities and Exchange Commission (SEC) was established on 16 May 1992 according with the passing of *SEA (1992)*. The main duty of the SEC is 'to supervise and develop the Thai capital market to ensure efficiency, fairness, transparency and integrity'.[114] The SEC is composed of three tiers: the SEC Board, the Capital Market Supervisory Board, and the Office of the SEC.

The SEC board is responsible for policy-level decisions and the development of the Thai capital market. The capital market supervisory board has a duty to supervise

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[111] 'Registrar' means the Director-General of the Commercial Registration Department, including the person entrusted by the Director-General of the Commercial Registration Department.

[112] The *PLC 1992* s 8.

[113] Ibid s 10.

[114] The Securities and Exchange Commission, *About the SEC* <http://www.sec.or.th/EN/AboutSEC/Pages/Introduction.aspx>.

securities business, whether such business is operations, public offering or business takeovers. The Office of the SEC has duties such as implementing policies and inspecting corporations.[115]

Companies listed on the Thai Stock Exchange can sell securities issuance to the public with the approval of the SEC. Thus, the SEC has a duty to verify completion of 'disclosed information and the issuer's compliance with corporate governance principles'.[116] The SEC also has a duty to verify management of the company directors whether in terms of conflicts of interest or conducting illegal activities, which may lead to unwanted results for investors. In addition, the SEC imposes a Code of Governance in order to control board members, management and staff in operating a business. The Code includes many criteria, such as accountability, responsibility, disclosure and transparency.[117] However, the core power and duties of the SEC are provided for in the *SEA*. This means that if the law does not provide power for the SEC in some situations, the SEC cannot legally intervene.

Thus, as regards insolvent trading in the Thai jurisdiction, the SEC does not have any power to control a listed company for trading while it is insolvent. This is a gap in the law through which company directors of listed companies can avoid liabilities, leaving investors potentially vulnerable to the negative impact of insolvent trading.

C *The Stock Exchange of Thailand*

Under Thailand's Second National Economic and Social Development Plan (1967-1971), a securities market was formally proposed and established for the first time to mobilise additional capital for national economic development.[118] The modern capital market in Thailand was established in two phases. The first phase occurred with the establishment of The Bangkok Stock Exchange, which was a private group and did not

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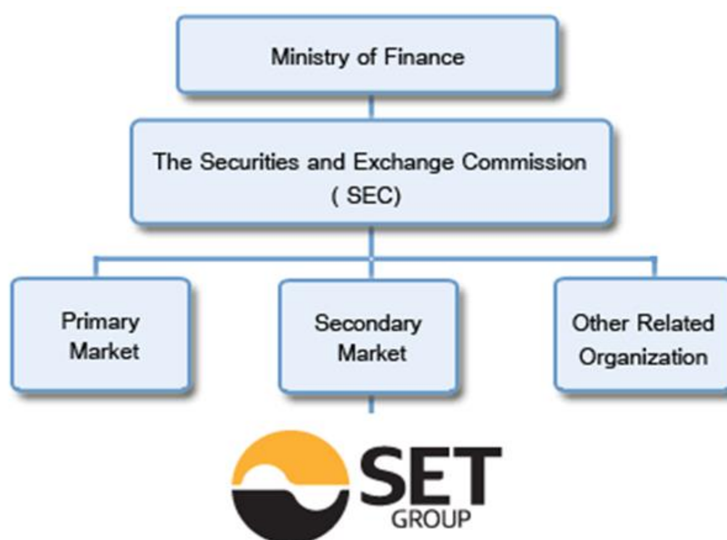
[115] The Securities and Exchange Commission, *Organization of the SEC* <http://www.sec.or.th/EN/AboutSEC/Pages/OrganizationSEC.aspx>.

[116] The Securities and Exchange Commission, *About the SEC*, above n 114.

[117] The Securities and Exchange Commission, *Codes of Governance* <http://www.sec.or.th/EN/AboutSEC/Pages/CodesOfGovernance.aspx>.

[118] The Stock Exchange of Thailand, *History & Roles* <http://www.set.or.th/en/about/overview/history_p1.html>.

succeed in its aim because of lack of support by the Thai government sector and lack of sufficient investors with knowledge about the equity market. The second phase began on 30 May BE 2518 (1975), with the establishment of the Securities and Exchange of Thailand – renamed on 1 January BE 2534 (1991) as the Stock Exchange of Thailand (SET).[119]



The main roles of Thai SET as stipulated by the *SEA* are:

1. To serve as a centre for the trading of listed securities, and to provide the essential systems needed to facilitate securities trading;
2. To undertake any business relating to the Securities Exchange, such as a clearing house, securities depository centre, securities registrar, or similar activities;
3. To undertake any other business approved by the SEC.[120]

Figure 2.1: Regulatory framework of the capital market in Thailand

Source: the website of the Stock Exchange of Thailand

<http://www.set.or.th/en/about/overview/history_p1.html>

[119] Ibid.

[120] Ibid.

Under the *SEA,* the SEC acts as the regulator of the Thai capital market and the SET is under the control of the SEC.

The SET provides procedures and guidelines for listed companies facing delisting due to operational or financial conditions (*Bor.Jor./Phor.* 11-00).[121] The procedures and guidelines specify four criteria leading to the delisting of companies:

1. The assets used in the company's operations have significantly decreased or will do so as a result of sale, disposition, rent or lease, separation, suspension of operations, abandonment, destruction, deterioration, seizure, expropriation or any other cause having the same effect;
2. Operations are halted entirely or almost entirely for any reason whatsoever, regardless of whether such cessation is due to an act of the company or not;
3. The auditor issues a disclaimer or an adverse opinion on the financial statements of the company for three consecutive years;
4. The company's latest audited financial statements or consolidated financial statements show that shareholders' equity is negative.[122]

The aims of the guidelines are to have concrete procedures and guidelines in place to resolve problems concerning listed companies in danger of being delisted. In addition, the guidelines aim to protect minority shareholders' interests, separate weak listed companies from financially strong ones, and increase the stimulation for company rehabilitation.

The SET procedures and guidelines identify the methods and operations for financially struggling companies:

1. If a firm falls into any of the conditions (a)-(d), above, SET will post an NC (Non-Compliance) sign on the company's securities to warn investors that the company could be delisted and, at the same time, will post a SP (Suspension) sign to note

[121] The Stock Exchange of Thailand, *Procedures and Guidelines for Listed Companies Facing Delisting Due to Operations or Financial Conditions* <http://www.set.or.th/dat/content/rule/en/BJP11ProceduresandguidelinesfordelistingConsolidateNo2.pdf>.

[122] Ibid.

that trading of the company's securities has been suspended. The SET will allow the firm up to three (3) years for rehabilitation (covering all three (3) stages - each of 1 year) and will keep the public informed at each stage. If, within three (3) years of entering rehabilitation, a firm is able to resolve its grounds for possible delisting, the NC and SP signs will be lifted to allow trading of its securities.

2. At the company's request, the SET may grant a one-time extension of up to one (1) year so that the firm can remain in a given stage for more than a year. In any event, the rehabilitation period cannot exceed four (4) years.
3. If the company is unable to meet the requirements to resolve its grounds for possible delisting and resume trading of its securities within the given period, the SET Board will consider approving delisting the company's securities.

Thus, the SET has three main duties in the case of listed companies experiencing financial problems:

First, there is a duty to post a sign for warning the investors that the company could be delisted. Second, the SET has a duty to prohibit that listed company to trade in a specific time. Third, there is a duty to inform the SEC of decisions in relation to a delisting of a company.

It is remarkable that the SET has no power or duty to punish the board of directors of listed companies who mismanage and eventually cause the corporation to become insolvent. Moreover, if the listed company finally becomes insolvent, the SET has no right to sue the company because the SET is not an injured person according to Thai corporate laws. There is no proactive duty imposed by Thai regulations or laws to encourage listed companies to avoid insolvency beyond applying the measure of reorganisation. An order to stop trading and to reorganise are the only options SET has to help listed companies to resolve problems caused by financial difficulty.

Likewise, the SEC has no duty provided by law if a listed company is likely to become insolvent. The SEC only has a duty to delist the listed companies as proposed by the SET. Hence, with regard to the role and duty of the SEC and SET, there is no proactive

measure available for those government offices to deal with the insolvent trading problem. There may be a need to find suitable measures for government offices which align with those of developed countries.

IV CONCLUSION

There are four main laws which relate directly to governing companies in the Thai jurisdiction: the *Civil and Commercial Code (1925)*, the *Public Limited Companies Act (1992)*, the *Securities and Exchange Act (1992)* and the *Bankruptcy Act (1940)*. The statutes have all been amended a number of times to bring them into line with current situations. Unfortunately, in the context of insolvent trading, the current Thai laws do not provide sufficient protection for creditors. Furthermore, the Thai laws do not have a specific provision and impose liabilities which directors have to take into account when a company is in an insolvent state. State agencies regulating companies also have no rights to control companies when they are in the state of insolvency.

The problem of insolvent trading under Thai jurisdiction, therefore, occurs because of an absence of specific provisions in order to deal with insolvent trading. More specifically, all related corporate laws, whether the *CCC*, *PLC (1992)*, *SEA* or the *Bankruptcy Act (1940)* fail to provide efficient measures and protection to stop a company director from trading while a company is insolvent and also to find a solution that will protect creditors. Furthermore, due to the lack of specific laws, state agencies, such as the SEC, do not have power to deal with insolvent trading. Thus it can be said that current Thai regulations and corporate state agencies do not have the capability to protect or prevent insolvent trading. The next chapter, Chapter 3, will discuss the problematic issues under Thai statutes to show why the current corporate laws cannot prevent insolvent trading.

CHAPTER 3: ISSUES FOR CREDITORS WHEN A COMPANY TRADES WHILE IT IS INSOLVENT

I INTRODUCTION

The growth of Thailand's economy has dramatically increased for the past four decades.[123] Thailand's economy is influenced by foreign investment by private and public companies, even though many corporate insolvency problems exist in the business sector in Thailand. Some of these problems occur as a result of limited knowledge of business practices by directors, but some occur because of fraud, recklessness or misconduct by directors, including breaches of a director's duty of loyalty and a duty to avoid conflicts of interest. One significant insolvency problem is insolvent trading where company directors are aware that the company is beyond the point of being able to pay its debts.[124] As a consequence of the absence of stringent rules, under Thai company laws, to impose a positive duty on company directors not to engage in insolvent trading, it is not surprising that companies continue to trade even though they are close to insolvency and, consequently, the interests of creditors are detrimentally affected. Indeed, current Thai laws are quite ineffective in regulating companies to avoid insolvent trading; especially, the laws assert that a director's personal liabilities for corporate collapses[125] need to be clarified.

This Chapter will outline a number of problems with current Thai laws that, it is suggested, are responsible for the capacity of companies to engage in insolvent trading. More specifically, the thesis will show that the duties and liabilities attributed to directors of companies do not extend to creditors especially in the case of the state of insolvency. The issues identified will be discussed under the following categories:

1 Strict adherence to the juristic person or separate legal entity principle;
2 Lack of definition of a director;

[123] KrongkaewMedhi, Chamnivickorn Suchittra and Nitithanprapas Isriya, *Economic Growth, Employment, and Poverty Reduction Linkages: the Case of Thailand* <http://www.ilo.org/wcmsp5/groups/public/@ed_emp/documents/publication/wcms_120671.pdf>. See also Jansen Karel, 'Thailand: The Making of a Miracle?' (2002) 32(2) *Development and Change* 343.

[124] Mark Byrne, 'Directors to Hide from A Sea of Liabilities in a New Safe Harbour' (2008) 22(3) *Australian Journal of Corporate Law* 255, 265-266.

[125] Helen Anderson, 'Directors' Liability for Corporate Faults and Defaults: An International Comparison' (2009) 18(1) *Pacific Rim Law & Policy Journal Association* 1, 1.

3 Uncertainty of required standard of care under Thai laws;
4 Insufficient statement of directors' liabilities;
5 Nonexistence of directors' duty when a company is in an insolvent state; and
6 Obstacles to reorganisation

II PROBLEMS WITH THAI CORPORATE LAWS

Under current Thai company laws, company directors are required to exercise their broad powers for the best interests of the company as a whole. In managing a company's business operation, the directors are under a duty to protect the interests of the company and shareholders. By implication, company directors are not required to protect the interests of creditors because, by law, they owe no duty to third parties. This means directors have no duty to stop a company from trading even if they are aware or have a reasonable suspicion that the company may be insolvent or on the brink of insolvency.

Thus, in the Asian Financial Crisis, directors of Thai companies, both private and public, may have been legally engaged in insolvent trading even though they were fully aware that the company was insolvent or would shortly become insolvent.[126] The directors of the near-insolvent companies exploited the legal lacuna to incur debts and rearrange the affairs of the company by, for example, selling assets, and so depleting any chance for creditors to recoup what they are owed. These actions may cause a chain reaction in which creditors of the companies experience financial difficulties because of non-payments, which causes them to fail and their employees to lose their jobs. Ultimately, this situation impacts the Thai economy, with neither creditors nor the Thai government having the statutory grounds to take legal action against company directors for recovery of the losses incurred as a result of insolvent trading.

The duty to prevent insolvent trading of a company is one of the most important obligations imposed on directors under the common law jurisdictions of Australia and the UK, and is dealt with by lifting the corporate veil of the company involved in

[126] There are two primary tests for determining insolvency: a balance sheet test and a cash flow test.

insolvent trading and making directors personally liable for company debts incurred while the company is insolvent.

The following sections will discuss reasons why current Thai laws are ineffective in dealing with the insolvent trading problem, as well as why the duties and liabilities of directors currently stated in corporate legislation are inadequate to protect creditors' interests, especially in the case of insolvent trading. Laws relating to insolvency and investment in Thailand will also be considered to indicate the difficulties concerning these statutes.

A *Strict Adherence to the Juristic Person Principle*

1 Agency Duties

As noted in Chapter 2, the duties of directors depend upon the company type. Companies registered in Thailand are of two broad types: private limited and public limited companies. Public companies can further be divided into those not listed on the Thai Securities and Exchange Market and those listed on the Thai Securities and Exchange Market (companies which aim to offer shares to the public or other persons). Although directors have different operational duties depending on the type of company, some duties are common. Duties as specified in the *CCC* are general duties which directors in any type of company have to follow. Other duties, such as those specified in the *PLC (1992)*, take precedence over those stated in the *CCC*.

The *CCC*, being the main legislation for determining and controlling the appropriate managerial role of directors of private companies, imposes duties and liabilities on directors for conducting the affairs of the company. This Code dictates that a director shall operate a company as a representative and agent of the company.[127] Section 1167 states that '[t]he relations between the directors, the company and third persons are governed by the provision of this Code concerning Agency'.

[127] *CCC* ss 70 and 1167.

The meaning of agency can be found in s 797.[128] Ekjariyakorn argues that the main points of the agency concept are: first, the agency is a personal status which cannot be transferred to other persons without consent of the principal; and second, an agent must have a fiduciary duty to the principal.[129] Given that company directors are representatives appointed by the principal, they owe a fiduciary duty to operate the company diligently and honestly.

With respect to public companies and listed companies, company directors are agents as provided in s 97 of *PLC (1992)* and s 89/3 of the *SEA*.[130] Thus, s 97 provides that '[u]nless otherwise stipulated in this Chapter, the relation between the directors and the company and the relationship between the company and third person shall be governed by the provisions of the Civil and Commercial Code relating to agency.'

It is also clear that, pursuant to these sections, directors in all types of companies are the agents of the company. Therefore, company directors of a private, public or listed and non-listed company are agents and have a duty to operate the corporation. On the other hand, directors have no duty to the company's creditors. There is no provision under Thai corporate laws providing for the duty of directors to creditors. Because directors are agents of the company and have agency duties, they must carefully operate the corporation for the benefit of the company only, not creditors.

Duties as provided in the *CCC* are general principles, and if there is a rule or law which is specifically applied for another kind of company, such as a public limited company or listed public company, that law or rule would be preferentially employed rather than the general principle, as explained in Chapter 2.

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[128] Ibid s 797 provides that:

> 'Agency is a contract whereby a person, called the agent, has authority to act for another person, called the principal, and agrees so to act.
>
> Agency may be express or implied.'

[129] Pataichit Ekjariyakorn, *Agency-Brokerage* (Winyuchon Publication House, 2011), 57-58.

[130] *SEA* s 89/3 specifies: 'A director shall have qualifications and shall not have prohibited characteristics as specified by law on public limited companies, and shall not have characteristics indicating a lack of appropriateness in respect of trustworthiness in managing business whose shares are held by public shareholders as specified in the notification of the SEC.

The *CCC*[131] specifies two common duties of directors: general duties and specific duties.

(a) General duties

The CCC specifies three types of general duties. The first is the duty to work within their power. The *CCC* s 812[132] states that directors will be held liable if they exceed the limit of their power. Second is the duty to be honest: directors shall work with honesty.[133] Third is the duty not to be negligent.[134] These are broadly the general agent's duties as company directors. In sum, directors' general agent duties are duties to act in good faith, act competently and not negligently, and act within their power imposed by laws, regulations or articles of association.

In the case of insolvent trading, however, the general agent duties are not sufficient to overcome the insolvent trading problem. For example, although directors are required to operate the company with honesty, when the company becomes insolvent, the requirement to act honestly is inadequate to protect the interests of creditors because it may be that the director worked scrupulously when faced with the company's difficult financial situation but was eventually unable to place the company in a situation to pay its debts; creditors therefore suffer because the company did not liquidate in time. In such circumstances, the directors can claim they acted with sincerity and, therefore, are able to avoid personal liability. It means that, in the insolvent trading case, there is a defence for directors to avoid any creditors' claims and avoid liability because the general director's duties, according to the *CCC*, do not provide proper measures to support any remedy for creditors. Furthermore, breaching of general duties is difficult to prove, especially for some duties where the directors'

[131] Some agent duties specified in the *CCC* overlap with the fiduciary duty as used in common law counties. For the fiduciary duty, this will be explained later in this chapter.

[132] *CCC* s 812 states that: 'The agent is liable for any injury resulting from his negligence or non-execution of agency, or from an act done without or in excess of authority'.

[133] Ibid ss 805, 810 and 811.

[134] Ibid s 812.

intention must be proven; for example, the duties to act with good faith and without negligence are difficult to prove.

In addition, in the case of *ultra vires* acts in relation to an agent's power, there is an interesting issue which often arises in the Thai business sector. Ratanakorn, who previously held the position of President of the Thai Supreme Court, notes that *ultra vires* can be divided into four classes:[135]

- Act of a director who had some defects concerning his appointment or his qualifications;
- Act of excessive agent power given internally by the company;
- *Ultra vires* specified in the company registration or regulations of the company;
- *Ultra vires* specified in the objectives of the company.

First, with regard to an act by a director whose appointment or qualification was later held to be defective: s 1166[136] states that all acts executed by the director are valid. This means that all acts carried out by a director occurring during the time in which there was an anomaly in his appointment or qualification nevertheless bind the company.[137] Therefore, if a director makes mistakes in relation to third parties, the third party cannot sue the director personally. This rule, however, does not include a director who has not been appointed or whose appointment is invalid.[138] Section 1166, therefore, does protect the interests of creditors when there is a claim regarding an act of a director who has an invalid appointment. The company is liable to an injured person, even to creditors, affected by the act of such a director but the director whose appointment is amiss by reason of his qualification or appointment is not personally liable to an injured person, including creditors.

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[135] Sophon Ratanakorn, *Explanation of the Partnership Company* (Nitibannagarn, 13rd ed, 2013), 387-407.

[136] *CCC* s 1166 provides that: 'All acts done by a director shall, notwithstanding that it be afterwards discovered that there was some defect in his appointment, or that he was disqualified, be as valid as if such person had been duly appointed and was qualified to be a director.'

[137] The measures of appointments are specified in s 1151–1153 and qualification of a director is imposed in s 1154 of the *CCC*.

[138] Ratanakorn, above n 135, 389.

Second, where an agent exceeds the power given internally by the company or by the general meeting of the company, or where the director acts without the consent of a general meeting, the issue is one that involves only management within the company. A third party is not expected to know about the scope of the power of a director. Thus, the act of a director which exceeds his/her power or is executed without consent of a general meeting is the responsibility of the company. The company cannot argue that it is not responsible to a third person who has acted in good faith. Thus, the company must take responsibility for the act perpetrated on the third person who is injured by the act of the director. This is the theory of estoppel which the *CCC* imposes in s 822[139] to protect an injured person affected by an act of a director. However, if a third person knows that a director does not have the power to act, the company can reject all liabilities that attach to the act made by the director.[140]

Third, a director commits an act that is specified as *ultra vires* in the company registration or regulations. The scope of a director's power is imposed in s 1111(6) of the *CCC*.[141] Moreover, a third party may investigate this power by examining the company registration or the company's regulations. In addition, ss 1021-1023 also specify that all documents published in the *Government Gazette* shall be deemed to be known to all persons. Therefore, if there is damage to a third party occurring from an *ultra vires* act of a director which is specified in the company registration or regulations of the company, the company can refuse to take responsibility for an act of the director that injures a person. The company can claim its right under ss 820 and 1167 to deny any responsibilities regarding the consequences of that act by the director. However, there are a number of cases in which a company has been held liable for the consequences to an injured person of an act by a director that exceeded the powers

[139] *CCC* s 822 indicates that: 'If an agent does an act in excess of his authority, but the third person had reasonable grounds, arising from the act of principal, to believe that it was within his authority, the provisions of the foregoing s apply correspondingly.'

[140] Ratanakorn, above n 135, 390.

[141] *CCC* s 1111(6) provides that:

> The application and entry in the register must contain, in conformity with the decisions of the statutory meeting, the following particulars: …
>
> (6) If the directors have power to act separately, their respective powers and the number or names of the directors whose signature is binding on the company.

provided by the registration or regulations of the company. Ratanakorn argues that the company may be held liable for the actions of directors according to other legal principles. [142] For instance, the company will be liable for the actions of its representatives,[143] agents,[144] ostensible agents[145] and by ratification.[146]

It can be concluded, therefore, that even when the director uses his power beyond his authority as specified in the company registration or regulations, the company still can be held liable to a third person or an injured person. It is too difficult to punish a director personally because the *CCC* and the courts may aim to protect injured persons rather than punish a director for using his power beyond the authority for him to do so. Therefore, there are many cases in which the court refers to the fact that the company will have responsibility for the injuries to a person rather than punishing directors.[147] However, the director could be sued by the company under s 1169 of the *CCC* if he caused damage to the company.[148]

Third, it is concerning a situation in which a director acts *ultra vires* the powers specified in the objectives of the company. Normally, the company is liable when an action is carried out within the objectives of the company.[149] However, if a director acts beyond the powers specified in the objectives of the company, then this action would be invalid and the company would not be bound. Yet, Thai courts have not applied this principle consistently and there is no judicial decision that has held that a contract made outside the objectives of the company is invalid.[150] The company, nevertheless, can reject liability if it does not derive any benefit from the contract or fails to ratify the contract. Therefore, if the company derives some benefit from the

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[142] Ratanakorn, above n 135, 391

[143] See Thai Supreme court case nos 645/2486, 388/2494, 3546/2525 and 1993/2536.

[144] See Thai Supreme court case nos 158/2509, 1671/2494 and 114/2536.

[145] See Thai Supreme court case no. 1078/2496, 1630/2509, 853/2521 and 2463/2532.

[146] CCC s 823 indicates that if an agent does an act without authority or beyond the scope of his authority, such act does not bind the principal unless he ratifies it.

[147] See Thai Supreme court case nos 645/2486, 388/2494, 1671/2494 and 2463/2532.

[148] Personal Liability of director under s 1169 of the *CCC* will be explained in detail later in this chapter.

[149] See Thai Supreme Court case nos. 1213-1215/2499, 1589/2511, 471/2519 and 1418/2522.

[150] See Thai Supreme Court case nos. 41/2509. Even though the case was about limited partnerships, the principle of law is the same. The court did not decide that the contract made outside the objectives of the company is invalid.

agreement or ratifies the agreement, it cannot renounce liability which may occur in the future.[151] Thus, when the company is involved in the agreement, the director who uses his power beyond that specified in the objectives of the company will not be held personally liable to the injured persons or third parties.

In light of the above discussion concerning the doctrine of *ultra vires*, it seems that it is difficult to punish a director for breaching his power as specified in law, regulations or objectives of the company. With the first two types of *ultra vires*, the *CCC* states clearly that the company shall be held liable to injured persons or third parties. In addition, with the last two types of *ultra vires*, a director may not have personal liability because there are other legal principles that hold the company liable and, also, if the company benefits from the director's actions or ratifies an agreement, the company will have to take sole responsibility. Therefore, it can be said that, regarding the *ultra vires* of directors, the *CCC* does not aim to impose liability on directors directly. The company is more likely to be held liable for the *ultra vires* actions of directors. One obvious reason may be that the company is probably more able to pay for the remedy than the director. This may be the reason why the *CCC* specifies that the company should be held liable in such cases.

Consequently, with respect to insolvent trading – an issue that would normally require a special provision to stop the problem – it is most unlikely that directors will be held responsible for the losses of creditors. The general duties as provided in the *CCC* do not support or protect creditors' interests by seeking to punish directors. There are many defects associated with the general duties of agents that would prevent them from being applied to issues of insolvent trading. In other words, it can be said that the general duties identified under the *CCC* are not sufficient to protect the interests of creditors, particularly when the company is in an insolvent state.

[151] Ratanakorn, above n 135, 402.

(b) Specific Duties

There are specific duties imposed on directors which require them to avoid conflicts of interest, enforce the resolutions according to the decisions of the general meeting and so on. For example, s 1168 para 2 (1)-(4)[152] imposes specific duties on directors, such as the duty of shareholders to actually pay for shares and the duty to properly distribute dividends or interest as prescribed by law. Moreover, directors also have significant duties to avoid conflicts of interest according to s 1168, paras 3 and 4. Directors must not enter into a transaction with a business having the same nature as a company's business. However, if directors have the consent of shareholders provided at the general shareholders' meeting, they can engage in that transaction.[153]

Directors also have a duty to call a general meeting[154] or an extraordinary meeting,[155] and a duty to create a balance sheet once every 12 months.[156] Generally, if a director breaches a specific duty, it is easy to prove that a director made a mistake because the duties are clearly stated by the *CCC*. However, available specific duties as provided in Thai corporate laws do not cover the case of insolvent trading. This means that neither general nor specific directors' duties effectively protect creditors' interests.

Interestingly, the *CCC*, as the main corporate law regulatory statute in the Thai jurisdiction, does not make any provision for when the company has financial difficulties, which could lead to the company becoming insolvent. There is not even an article providing a duty on directors to consider the benefits or interests of the creditors

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[152] *CCC* s 1168 para 2 states:

In particular they are jointly responsible:

(1) For the payment of shares by the shareholders being actually made;
(2) For the existence and regular keeping of books and documents prescribed by law;
(3) For the proper distribution of the dividend or interest as prescribed by law;
(4) For the proper enforcement of the resolution of the general meetings.

[153] Ibid s 1168 para 3 provides: 'A director must not, without the consent of a general meeting of shareholders, undertake commercial transaction of the same nature as and competing with that of the company, either on his own account or that of a third person, nor may he be a partner with unlimited liability in another commercial concern carrying on a business of the same nature as and competing with that of the company.'

The foregoing provisions apply also to persons representing the directors.

[154] Ibid s 1171.

[155] Ibid s 1172.

[156] Ibid ss 1196–1199.

who may be affected severely if the company becomes deeply indebted. Because of the absence of a specific duty under the *CCC* to prevent insolvent trading, creditors in Thailand take a risk when a company is nearing insolvency.

With regard to public and listed companies, the *PLC (1992)* and *SEA* also include specific duties for directors to be loyal and to avoid conflicts of interest. Nevertheless, these laws also contain defects in relation to the prevention of insolvent trading.

With regard to the duty to avoid conflicts of interest, the *PLC (1992)* s 86[157] provides that directors must not 'operate any business which has the same nature as and is in competition with the business of the company or become a partner in an ordinary partnership' and so on which aims to seize benefits of the company. If directors breach this duty, there is a sanction for them pursuant to para 2 of the same section.[158] However, if directors notify the meeting of shareholders of their involvement with the other company prior to their appointment and the meeting approves of that involvement, they can be 'a partner in an ordinary partnership or become a partner with unlimited liability in a limited partnership' or do the same kind of business as the company they manage according to s 86 of the *PLC (1992)*.

Chotisingha[159] makes four points with regard to s 86:

1. Even though s 86 of the PLC provides that directors shall notify the meeting of shareholders before they are appointed, it is risky for the directors since they could be sued for failing to work wholeheartedly for the benefit of the company in order to benefit the competitor company.

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[157] *PLC 1992* s 86 states: 'The director shall not operate any business which has the same nature as and is in competition with the business of the company or become a partner in an ordinary partnership or become a partner with unlimited liability in a limited partnership or become a director of a private company or any other company operating business which has the same nature as and is in competition with the business of the company, either for his or her own benefit or for the benefit of other persons, unless he or she notifies the meeting of shareholders prior to the resolution for his or her appointment.'

[158] *PLC 1992* s 86 para 2 specifies: 'In the case where a director violates paragraph one, the company may claim compensation for damage caused by such director, provided the suit shall be brought to court within one year of the date of notice of such violation and not more than two years from the date of the violation.'

[159] Sutin Chotisingha, *Status, Powers, Duties and Responsibilities of Executive Directors and Non-Executive Directors* (Master of Law Thesis, Chulalongkorn University, 2001), 117-119.

2. The principle which prohibits directors from being a partner in an ordinary partnership or becoming a partner with unlimited liability in a limited partnership or becoming a director of a private company or any other company operating a business which has the same nature as and is in competition with the business of the company is not identified in the *CCC*. Therefore, this principle should be added to the *CCC* to avoid the competitive problem.
3. The consent of the meeting of shareholders may be fraudulently achieved, particularly in circumstances where the directors are the main shareholders or where they have a lot of relatives. This would not be fair to the minority of shareholders. Hence, it is necessary to reform this provision.
4. Even if the directors have the consent of the shareholders meeting to be involved in a rival company, there should be prohibitions on the director disclosing trade secrets.

Moreover, in the context of the duty to avoid conflicts of interest, a director cannot purchase or sell the property of the company or to the company without the consent of the board of directors. If a purchase, sale or deals are made, they shall not bind the company pursuant to s 87 of the *PLC (1992)*.[160] However, this section seems to indicate that a consent must be approved of by the director himself. If there are only five directors in the public limited company and they are relatives, it is possible to easily obtain consent. This may cause the company damage.[161] According to s 88 of the *PLC (1992)*, directors in a public company also have a duty to notify shareholders when there is direct or indirect interest in any contract which is made by the company during a fiscal year.[162]

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[160] *PLC 1992* s 87 provides: 'If any director purchases property of the company or sells property to the company or conducts any business with the company, regardless of whether it is in his or her own name or in the name of other persons, unless approved by the board of directors, such purchase, sale or deal shall not bind the company.'

[161] Chotisingha, above n 159, 122.

[162] *PLC 1992 s 88* states:

'A director shall notify the company without delay in the following cases:

(1) having a direct or indirect interest in any contract which is made by the company during an accounting year, and shall indicate the nature of the contract, names of the contracting party and interest of the director in the contract (if any);

The duty to avoid conflicts of interest is specified in s 89,[163] in which the company is not allowed to grant a loan to any director. The company in this section, in fact, means the board of directors because the company is a legal entity managed by representatives or agents who are, certainly, the board of directors. Therefore, it is problematic if the director can grant a loan to himself or to relatives of directors. This will cause damage to minority shareholders, the company's financial situation or even to creditors' interests. For this reason, *PLC (1992)* does not allow the company to grant a loan to any director or to staff or to an employee.

Section 89 of *PLC (1992)* is quite useful for protecting the interests of the company. However, a similar legal provision does not appear in the *CCC*. In other words, a director in a private company can grant a loan to himself. If giving a loan causes damage to the company, he would not be punished because the *CCC* does not prohibit a director from giving a loan to himself.[164] It is better to reform the *CCC* in order to protect the interests of the company and the minority shareholders' rights.

With regard to the insolvent trading problem, there are gaps in the law regarding avoiding the conflicts of interest discussed above. For example, the board of directors

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(2) holding shares or debentures of the company or an affiliated company, and shall indicate the total number of shares increasing or decreasing during an accounting year (if any).'

[163] *PLC 1992* s 89 provides that:

The company shall not grant a loan to any director, staff or employee of the company unless:

(1) granting of a loan in accordance with the regulations on the welfare of the staff and employees; or

(2) granting of a loan in accordance with the law on commercial banking, life insurance, or other laws.

The granting of a loan referred to as follows shall be regarded as the granting of a loan to a director, staff or employee of the company under paragraph one:

(a) the granting of a loan to a spouse or a child who is not sui juris of a director, staff or employee;

(b) the granting of a loan to an ordinary partnership in which a director, staff or employee or spouse or child who is not sui juris of a director, staff or employee, is a partner;

(c) the granting of a loan to a limited partnership in which a director, staff or employee or spouse or child who is not sui juris of a director, staff or employee, is a partner with unlimited liability;

(d) the granting of a loan to another company or private company in which a director, staff or employee or spouse or child who is not sui juris of the director, staff or employee holds shares totalling more than one half of the total number of shares of such company or private company.

The granting of a loan under paragraph one shall include giving a guarantee for a purchase or discount of a bill and the granting of collateral for the repayment of a loan.

[164] Chotisingha, above n 159, 122-123.

can grant a loan to themselves or to relatives of directors if they have enough power by not violating the law. Thus it is possible that if the public company is going to be insolvent, the board of directors may defraud creditors' money by asking for a loan from their relatives. Delivering money in that way is legal under current Thai law but it is not fair to creditors. To conclude, it can be claimed that the duty to avoid conflicts of interest specified in the *PLC (1992)* does not preserve the interest of creditors, particularly in the case of insolvent trading.

With regard to a listed public company, the *SEA* provides directors with duties to avoid conflicts of interest according to ss 89/12 to 89/14 which are different from those specified in the *CCC*. Section 89/12 and 89/13 deal with making transactions which relate to the company's interest between directors, executives, company, subsidiary, and a related person.[165] Moreover, directors also have a duty to notify related interests

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[165] *SEA* s 89/12 provides:

'A director, an executive or a related person may enter into any transaction with the company or subsidiary only after obtaining approval from the shareholders' meeting unless such transaction is categorized as any of the following manners :

(1) a transaction with the same commercial terms as those an ordinary person would agree with any unrelated counterparty under similar circumstances, on the basis of commercial negotiation and without any dependent interest resulted from the status of the director, executive or related person, as the case may be, provided further that the said commercial terms have been approved by the board of directors or in compliance with the principle approved by the board of directors;

(2) a loan in accordance with the regulations on the welfare for staff members and employees;

(3) a transaction in which the counterparty to the company or both parties are:

(a) a subsidiary or subsidiaries whose shares are held by the company in the amount not less than ninety percent of its total number of shares sold; or

(b) a subsidiary or subsidiaries whose shares are held by a director, an executive or a related person or in which such person has interest, whether directly or indirectly, not more than the amount, rate or characteristic as specified in the notification of the Capital Market Supervisory Board;

(4) a transaction in a particular category or with value not more than the amount or rate as specified in the notification of the Capital Market Supervisory Board.

In specifying the notification under (3) (b) or (4), the Capital Market Supervisory Board may prescribe that the specified transaction shall be approved by the board of directors.

The provision of S 87 of the Public Limited Companies Act B.E.2535 shall not apply to the transaction between the director and the company or the subsidiary.'

SEA s 89/13 states:

'Where circumstances render it reasonable, by considering the significant results of the transaction to the company or the relationship between such transaction and the ordinary business of the company, the Capital Market Supervisory Board shall be empowered to specify the rules governing the following matters applicable to the transaction between the company or the subsidiary and a director, an executive or a related person:

(1) disclosure of information in relation to entering into such transaction to general investors, or in a notice calling a meeting of the board of directors or a shareholders' meeting;

or a related person's interests in relation to management of the company to avoid a conflict of interest pursuant to s 89/14 of *SEA*.[166] However, the provisions regarding a duty to avoid a conflict of interest noted in the *SEA* are applied generally regardless of the company being in a difficult financial situation. This means that when the company comes within the state of insolvency, there is no particular law to consider concering a director's conflict of interest. In other words, the duty to avoid a conflict of interest as provided in the *SEA* may not be suitable to protect the company's or creditors' interests, particularly when the company is becoming insolvent.

With regard to the duty of loyalty, public company directors have a duty to disclose any information that may be directly or indirectly in the company's interests. This duty is provided for in s 88 of *PLC*.[167] Directors in a public company are a group of persons who have a duty to take care of the benefits and properties of the public company. There are many people who invest in this kind of company. Hence, it is necessary to be strict about the types of people appointed. Therefore, there is a requirement that company directors act transparently so that shareholders are able to trust that the directors will not damage the company and thus affect shareholders.[168]

Section 88, however, does not provide for the scope of the information required; so directors can simply provide general information about themselves, such as they are a shareholder of a contracting party or that they have direct or indirect interests with the company.[169] It would be better to have a provision which specifies the scope of the

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(2) number of votes at the shareholders' meeting in the resolution which approves entering into such transaction.'

[166] *SEA* s 89/14 states: 'A director and an executive shall file with the company a report on his interest or a related person's interest in relation to management of the company or the subsidiary in accordance with the rules, conditions and procedures specified in the notification of the Capital Market Supervisory Board.'

[167] *PLC 1992* s 88 specifies:

A director shall notify the company without delay in the following cases:

(1) having a direct or indirect interest in any contract which is made by the company during an accounting year, and shall indicate the nature of the contract, names of the contracting party and interest of the director in the contract (if any);

(2) holding shares or debentures of the company or an affiliated company, and shall indicate the total number of shares increasing or decreasing during an accounting year (if any).

[168] Singhaviriya (2010), above n 81, 153.

[169] Chotisingha, above n 159, 125.

information because general information may not be enough for shareholders or investors to decide about investing or trusting the directors operating the company. Moreover, this principle is not, but should be, identified in the *CCC* to protect the benefits of the company.

In terms of a listed public company, directors in a listed company have a duty of loyalty, as identified in s 89/7:

> In conducting the business of the company, a director and an executive shall perform his duty with responsibility, due care and loyalty, and shall comply with all laws, the objectives, the articles of association of the company, the resolutions of the board of directors and the resolutions of the shareholders' meeting.

This section is quite similar to the directors' duty imposed by the *CCC* and *PLC* (1992), according to which directors must perform their duties responsibly, and with due care and loyalty. Directors have to operate the company according to all laws, the objectives, the articles of association of the company, the resolutions of the board of directors and the resolutions of the shareholders' meeting. Directors of a subsidiary company have the same duty as specified in s 89/24.[170]

Moreover, s 89/10 of *SEA* specifies that a director and executive must act in good faith with appropriate aims of benefitting the company and by not acting in conflict with the interest of the company.[171] To help define the scope of this duty, *SEA* s 89/11 provides examples of conflicted acts that may affect the interest of the company.[172]

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[170] *SEA* s 89/24 states:

'The provisions of S 89/7, S 89/8, S 89/9 and S 89/10 including related penalty provisions shall apply mutatis mutandis to the performance of directors and executives of the subsidiary.

The provisions of the first paragraph shall apply mutatis mutandis to the persons referred to in S 89/22(1) and (2) of the subsidiary.'

[171] *SEA* s 89/10 provides:

In performing duty with loyalty, a director and an executive shall:

(1) act in good faith for the best interest of the company;

(2) act with proper purpose and;

(3) not act in significant conflicts with the interest of the company.

[172] *SEA* s 89/11 states:

'Any of the following acts which provides a director, an executive or a related person any financial benefits other than those that should be ordinarily obtained or causes damages to the company shall be presumed significant conflict with the interest of the company:

Nevertheless, the definition of duty of loyalty in the section is still broad, such as the statement to act in good faith for the best interest of the company, which is difficult to specify. There are no court cases that refer to this duty and no explanation by the Supreme Court to help further define this duty.[173] This duty is, therefore, an unclear standard for directors of listed companies to apply.

In summary, an agent's duties, whether general or specific, as provided under Thai corporate laws are not effective in preventing the problem of insolvent trading. One significant issue is that Thai corporate laws do not impose a specific duty on directors to operate the corporation carefully, particularly when the company is in financial difficulty. To resolve this problem, Thailand needs to add particular provisions or reform corporate laws and impose such specific duties for directors to prevent insolvent trading.

2 Corporate Veil

As already outlined, when a company is set up, the liabilities of a juristic person are distinct from those of shareholders and directors.[174] Thus using the shield of a registered company to protect shareholders and directors from liabilities has grown in popularity.[175] The *CCC* states in s 1096: 'a limited company is that kind of which is formed with a Capital divided into equal shares, and the liability of the shareholders is limited to the amount, if any, unpaid on the shares respectively held by them'.

Therefore, companies are established in order to protect directors and shareholders from liabilities which go beyond the unpaid amount of shares. The *CCC* section

(1) entering into transaction between the company or the subsidiary and the director or related person which does not comply with S 89/12 or S 89/13;

(2) use of learned information other than that already disclosed to the public or;

(3) use of asset or business opportunity of the company in contravention of the rules or general practice as specified in the notification of the Capital Market Supervisory Board.'

[173] Information based on the search engine provided by the Supreme Court website as of 1 February 2016 at <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

[174] *CCC* s 1015 states that: 'A partnership or company, upon registration being made according to the provisions of this Title, continues a juristic person distinct forms the partners or shareholders of whom it is composed.'

[175] Pichai Ponpai, 'Whether Thai Courts Accept the Piercing of the Corporate Veil ' (2007) 8 *Paritah Court of Justice Journal* 27, 27-28.

indicates that Thai law is strict in applying the principle of the corporate veil, which involves the separation between a legal entity and a person, as well as providing for limited liability. Thus, if the corporation becomes insolvent, directors and shareholders of the company cannot be made insolvent in the same way as the corporation. Company creditors cannot claim any remedy from directors and shareholders because only the company has liability to creditors, not the shareholders or directors.[176] Popular phrases in the Thai business context which describe undesirable results of the application of the corporate veil principle are: ‘falling on a cushion’ and ‘falling on wealth’.[177]

The corporate shield also protects the shareholders and directors of a company from liability if shareholders and creditors finally suffer as a result of the company – whether intentionally or negligently – trading while it is insolvent or becoming insolvent. Thus, the corporate veil principle does not protect creditors’ interests under current Thai corporate law, and shareholders or directors may take advantage of the principle to defraud creditors or third parties. Therefore, a means of piercing the corporate veil or lifting it in some circumstances should be adopted to protect creditors’ interests.

The lifting or piercing of the corporate veil is well known in the company law.[178] Ramsay and Noakes argue that

> “Piercing the corporate veil” refers to the judicially imposed exception to the separate legal entity principle, whereby courts disregard the separateness of the corporation and hold a shareholder responsible for the actions of the corporation as if it were the actions of the shareholder. A court may also pierce the corporate veil where requested to do so by the company itself or

[176] See Praphrut Chatprapachai, ‘Piercing the Corporate Veil Doctrine in Comparative View’ on Law Features, *Thailand Law Forum* (17 April 2014) <http://www.thailawforum.com/piercing-the-corporate-veil-doctrine-in-comparative-view/>.
[177] Ponpai, above n 175, 27.
[178] Smadar Ottolenghi, 'From peeping behind the Corporate Veil, to ignoring it completely' (1990) 53(3) *The Modern Law Review* 338, 338.

shareholders in the company, in order to afford a remedy that would otherwise be denied, create an enforceable right, or lessen a penalty.[179]

Also, Harshit supports that

> Two general reasons why exceptions to the separate entity principle exist can be identified. First, although a corporation is a legal person, it cannot always "be treated like any other independent person." For example, a corporation is not capable of committing a tort or a crime requiring proof of mens rea unless courts disregard the separate entity and determine the intention held by the directors and/or shareholders of the corporation. Secondly, strict recognition of the principle may lead to an unjust or misleading outcome if interested parties can "hide" behind the shield of limited liability.[180]

Thai courts have the power to order the lifting or piercing of the corporate veil via s 5 of the *CCC*, which states that '[e]very person must, in the exercise of his rights and in the performance of his obligations, act in good faith.' However, only a few Thai court cases[181] have made use of this section.[182] It is possible that courts are reluctant to lift the corporate veil to protect creditors' interests in the Thai legal context because Thai courts interpret the law literally, or put differently, they strictly adhere to the black letter law that states that there is a distinction of liabilities between a juristic person and a person when a company is set up. The need for Thai courts to overcome this reluctance will be further discussed later in this thesis.

B *Lack of a Definition of Director*

One of the significant problems under Thai corporate laws is an absence of a definition of 'director' in either the *CCC* or *PLC (1992)*. A company, whether private or public, is

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[179] Ian Ramsay and David B Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19 *Company and Securities Law Journal* 1, 2.

[180] Harshit Saxena, *Lifting of Corporate Veil* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1725433>

[181] Ponpai, above n 175, 27.

[182] Thai Supreme Court case nos: 1131/2554, 2637-2638/2553, 7104/2546, 3969/2529 and 1550/2527.

controlled by directors or a board of directors. In relation to dealings between a company and outsiders, directors are regarded as agents of the company.[183] Nevertheless, in practice, many companies are controlled by *de facto* directors or by shadow directors.

CCC does not define the meaning of director; s 1151 is only concerned about the appointment of a director: '[a] director can be appointed or removed only by a general meeting.' To gain an understanding of the meaning of a director under *CCC*, it is necessary to examine Supreme Court decisions,[184]

The court holds that a company director is a person elected by a general meeting of a company's shareholders, having powers and duties under the control of the general meeting of shareholders according to the regulations of the company. According to the Supreme Court, a company director means an executive director, but there are cases in which the Thai Supreme Court held that the word 'director' also includes a non-executive director. In its decision no 1980/2519 (1976), the Thai Supreme Court ruled that non-executive directors who did not have duties to conduct the day-to-day affairs of the company are representatives of the company, and only have a duty to make suggestions in the directors' meeting. If damages incurred by the company were not clearly specified in accordance with s 1168 of *CCC* in which executive directors are jointly liable for the debts of the company, non-executive directors are not liable. This means that non-executive directors are subject to duties only as provided in s 1168 of *CCC*. This decision was overturned by the Supreme Court in subsequent cases: in 1998 and 2002, the Thai Supreme Court confirmed that all directors, whether executive or non-executive directors, must conduct the company's business with the 'diligence of a careful business man'. The Court went on to hold that in the event that non-executive directors breached their duty of care and diligence resulting in loss or damage to the company, they could be held personally liable to the company. Furthermore, the Court pointed out that non-executive directors could not claim that they are not expert in this

[183] Chantree Sinsuppharoek, The Explanation of the Civil and Commercial Code Concerning Partnership and Company (Winyuchon Co, 2013), 165. See also CCC s 1167.

[184] See Thai Supreme Court case no. 3465/2542.

kind of business or that they are not working in full-time employment because they must have sufficient knowledge to operate the company to become a director.[185] Therefore, non-managing directors also have a duty of care and practice diligence to operate the company as specified in s 1168 of *CCC*.

There is no case law in which the Thai Supreme Court refers to *de facto* and shadow directors.[186] This is not surprising since Thai courts traditionally adhere to black letter law. If the Code or Acts do not provide substance, the Thai courts usually do not make or create a law. This is the nature of civil law in Thailand. Thus, *de facto* and shadow directors, under Thai jurisdiction, do not have any duties or liabilities to the company, shareholders and third parties. *De facto* and shadow directors, therefore, are not included in the meaning of director under the *CCC*.

Like the *CCC,* the *PLC (1992)* does not provide a definition of 'director' for non-listed public companies. Sections 67[187] and 68[188] of *PLC (1992)* provide only that the company shall have a board of directors comprising at least five directors, and directors must have certain qualifications, such as a director shall be *sui juris* and not be bankrupt, incompetent or quasi-incompetent. Thus, Thai courts have used the meaning of public company directors by applying the meaning under *CCC*.

With respect to a listed company, the *SEA* defines the term 'director' in s 89/1 as:

> "board of directors" means the board of directors of a company
> "director" means a director of a company.

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[185] See Thai Supreme Court case no. 2191/2541 (1998) and 977/2545 (2002).

[186] Information based on the search engine provided by the Supreme Court website as of 5 February 2016 at <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

[187] *PLC 1992* s 67 provides: 'The company shall have a board of directors consisting of at least five directors to conduct the business of the company and not less than half of whom shall reside within the Kingdom.'

[188] *PLC 1992* s 68 states:

The directors shall be natural persons and shall:

(1) be sui juris;

(2) not be bankrupt, incompetent or quasi-incompetent;

(3) not have been imprisoned by a final judgment to a term of imprisonment for an offense against property with dishonest intent;

(4) not have been expelled or removed from the official service, a state organisation or a state agency on the ground of dishonest performance of duties.

Moreover, section 89/22[189] also imposes duties and responsibilities of director and executive officers including a number of persons such as interim executive, planner and liquidator. However, neither s89/22 nor s 89/1 give a clear definition of director. It should be noted that the definitions under both sections exclude both de facto and shadow directors. Consequently, it can be claimed that the definition is unclear with respect to who a company director is. Again, the meaning of director provided in *CCC* is applied to identify the position of director. However, as already noted, the meaning of directors under *CCC* applies only to executive and non-executive directors, and does not include shadow directors.

A significant problem for Thailand, particularly in the case of insolvent trading, is that, many companies are controlled by *de facto* or shadow directors. These kinds of directors cannot be held liable to shareholders, a third party or even a creditor because they do not have any duty provided by Thai laws. They are free to do anything, even though it may affect the company's interests. This gap in Thai law potentially enables shadow directors to avoid liabilities, and defraud creditors and investors.

C *Uncertainty Concerning the Standard of Care under Thai Laws*

An important duty of directors to ensure good corporate governance is the duty of care.[190] This duty requires that directors exercise their power with care and diligence for the benefit of the corporation. For a Thai private company, a duty of care for

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[189] *PLC* 1992 s 89/22 states: 'the provisions in relation to duties and responsibilities of director and executive under Section 89/7 to Section 89/21 including the related penalty provisions shall apply mutatis mutandis to the following persons:
(1) interim executive, planner, plan administrator and interim plan administrator under
the law on bankruptcy. In cases where such person is a juristic person, it shall
include relevant directors and executives of such juristic person;
(2) liquidator.'

[190] See also Melvin A Eisenberg, 'The Duty of Care of Corporate Directors and Officers' (1989) 51(1) *University Of Pittsburgh Law Review* 945, 945; Melvin claims that '[t]he duty of care of corporate directors and officers is a special case of the duty of care imposed throughout the law under the general heading of negligence. All law builds on moral, policy, and experiential propositions. The law of negligence is no exception. The moral proposition that underlies the law of negligence is that if a person assumes a role whose performance involves the risk of injury to others, he is under a moral duty to perform that role carefully.'

directors is specified in s 1168 para1 of *CCC*.[191] Directors must operate their company with the diligence of a businesslike standard. Directors cannot use the normal standard of an ordinary person in conducting a company.[192] The Thai Supreme Court has established the standard of 'diligence of a careful businessman'[193] holding that s 1168 imposes a duty of care on every director to conduct the company's business with the diligence of a careful business man. For example, in case no. 2191/2541, a director of a commercial bank must conduct the company business with the standard knowledge of a careful businessman. The case was decided by the Supreme Court, and the defendant was a director of a commercial bank. The court held he had a duty to take care of the business administration of the plaintiff. However, the director granted credit without enough security and also did not follow-up on the non-performing loan. The court ruled that the defendant could not reject responsibility by claiming that he did not know about the plaintiff's management. The court held that in such circumstances, a defendant should have knowledge of the problem or act with the common sense that an ordinary person who engages in that kind of business should have.

However, the meaning of the 'diligence of a careful businessman' standard has been applied variously depending upon circumstances, such as how big the company is, and whether it is a small family business or a large business.[194] This duty of care, under s 1168, is, again, not applied to shadow directors. There has been no case decided by the Thai Court where shadow directors must operate a company with the duty of care pursuant to s 1168.[195]

For a public limited company, s 85 para 1 of *PLC (1992)* imposes a duty of care on directors so that:

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[191] *CCC* s 1168 provides: 'The directors must in their conduct of the business apply the diligence of a careful business man.'

[192] Ratanakorn, above n 135, 410.

[193] Thai Supreme Court case no. 2191/2541 (1998).

[194] Ratanakorn, above n 135, 410.

[195] Information based on the search engine provided by the Supreme Court website as of 3 February 2016 at <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

> In conducting the business of the company, the directors shall comply with all laws, the objects and the articles of association of the company, and the resolutions of the meeting of shareholders in good faith and with care to preserve the interests of the company.

It is clear that directors must perform their duties with loyalty and due care towards the firm. However, there is a lacuna regarding the standard of care to be applied to company directors under this section. Varayudej points out that this section does not clearly identify a standard of care for business administration. A court has to interpret this section by using judicial discretion on a case-by-case basis.[196] Therefore, there is a need to resolve this problem by providing more certainty about what this term means.[197] Ratanakorn suggests that the standard of care for directors under s 85 of the *PLC* should be the same standard as that identified in the *CCC*.[198] However, no Supreme Court decision has ever addressed an allegation under s 85 of *PLC*.[199]

In respect of a listed public company, the *SEA* imposes an obvious and higher duty of care on directors greater than that provided in *PLC (1992)*. Directors have to operate a company responsibly, and with due care and loyalty.[200] *SEA* adds provisions concerning the duty of care for directors in conducting a listed company. There are three main provisions:

Standard of care

S 89/8 of the *SEA* states that '[i]n performing duty with responsibility and due care, a director and an executive shall act in the similar manner as an ordinary person undertaking the like business under the similar circumstance.'

This section clearly imposes a standard of care similar to that required under s 1168 of the *CCC*. However, this standard does not appear in the *PLC 1992,* as already noted

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196 Varayudej, above n 13, 159

197 Ibid 163.

198 Ratanakorn, above n 135, 410.

199 Information based on the search engine provided by the Supreme Court website as of 3 February 2016 at <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

200 *SEA* s89/7; See also The Securities and Exchange Comission, *Director's Handbook - Roles, Duties and Responsibilities of Directors and Board of Directors* (Thai Institute of Directors, 2007) 6-9.

above. Directors, therefore, in a listed company, must abide by a standard of care which is higher than the standard of a person of ordinary prudence; they must adopt the standard of an ordinary person who undertakes 'a like business under similar circumstances.' However, no cases have been brought to the Thai Supreme Court in which the Court has had to interpret the exact meaning of an ordinary person undertaking 'a like business under similar circumstances.'[201] A reason for such a lack of cases may be that, in the Thai litigation context, most plaintiffs will try to claim damages by suing on the basis of more concrete evidence, such as breach of an agreement or physical damages, rather than abstract evidence such as breaching a duty of care.

Directors' Decision Making: A Business Judgement Rule

Generally, in operating a company, directors are persons who have to make decisions about the direction of the company. If they make a correct decision, the company is more likely to succeed, whereas if decisions are incorrect, the company will likely lose money, which may affect its financial status, shareholders' interests and so on. Therefore, ensuring the proper decision-making processes of directors is very important for companies. Section 89/8, para 2, of the *SEA*[202] imposes three principles for determining whether directors have made a decision in accordance with the required responsibilities and with due care:

- The decision has been made with an honest belief and on reasonable grounds that it is for the best interest of the company.
- The decision has been made in reliance on information honestly believed to be sufficient.

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[201] Information based on the search engine provided by the Supreme Court website as of 27January 2016 at <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

[202] *SEA* s 89/8 para 2 specifies:

> Any matter proven by the director or executive that, at the time of considering such matter, his decision has met the following requirements shall be deemed that the said director or executive has performed his duty with responsibility and due care under the first paragraph:
>
> (1) decision has been made with honest belief and reasonable ground that it is for the best interest of the company;
>
> (2) decision has been made in reliance of information honestly believed to be sufficient; and
>
> (3) decision has been made without his interest, whether directly or indirectly, in such matter.

- The decision has been made without the director's interest, whether directly or indirectly.

In the past, Thailand did not have these *SEA* imposed principles. The *SEA* has been developed to provide the principles for guiding directors in their decision-making processes, providing clear meanings and standards to guide directors to meet the standard of care[203] as specified in s 89/8 para 2 (1–3). Nevertheless, in making a business decision on a complicated case, directors may be required to consult with a professional or ask for expert advice in order to determine the best direction for the company. The *SEA* does not impose a clear rule regarding information received from a professional or an expert and thus does not provide directors with guidance on whether to trust the information provided or not, which causes uncertainty when verifying whether directors have properly performed their duty of care.

Lertnuwat claims that the principles as provided in s 89/8 of the *SEA* are a safe harbour for directors. Directors thus can make a decision without fear of being sued. Even if the final result is different from their expectation, the business judgment rule will be a shield from personal liability for directors.[204]

In common law countries, such as Australia and the US, there are statutory provisions to solve this problem. For instance, s 189 of the Australian *Corporation Act 2001*[205]

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[203] Supansa Chirachotkachonkun, *Legal Problems Regarding Corporate Governance Measures with Respect to the Securities and Exchange Act (no. 4) B.E. 2551: Study on Directors' Duties and Liabilities* (Master of Laws Thesis, Chulalongkorn University, 2008), 154-155.

[204] Nilubol Lertnuwat, *Legal Framework for Promoting Minority Shareholders' Protection in Thailand* (PhD Thesis, Victoria University, 2012), 164.

[205] The *Corporation Act 2001* (Cth) s 189 states:

If:

(a) a director relies on information, or professional or expert advice, given or prepared by:

(i) an employee of the corporation whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned; or

(ii) a professional adviser or expert in relation to matters that the director believes on reasonable grounds to be within the person's professional or expert competence; or

(iii) another director or officer in relation to matters within the director's or officer's authority; or

(iv) a committee of directors on which the director did not serve in relation to matters within the committee's authority; and

(b) the reliance was made:

(i) in good faith; and

embeds rules about the extent to which directors can rely upon the information or advice provided by others. The US *Model Corporation Act 2005* provides standards of conduct for directors when they do not have appropriate knowledge and have to rely on a specialist or experts.[206] Therefore, to improve Thai law, it is necessary to reform current laws and add more standards of directors' conduct to establish whether directors are performing their duty of care properly.

Factors for Consideration in the Duty of Care

The *SEA* imposes in s 89/9 that:

> In considering whether each director or executive has performed his duty with responsibility and due care, the following factors shall be taken into account:
>
> (1) position in the company held by such person at that time;
>
> (2) scope of responsibility in the position of such person in accordance with the laws or as assigned by the board of directors; and
>
> (3) qualification, knowledge, capability, and experience including purposes of appointment.

Section 89/9, therefore, seems to acknowledge that each director must comply with a combination of both objective and subjective tests. Directors who are appointed for a task will have more responsibility than other directors not appointed for that task. Nevertheless, responsibilities of directors' are still determined under s 85 of *PLC (1992)* and s 89/7 of *SEA*.[207]

Thus, the duty of care under *SEA* is deficient, particularly with regard to which standard of care should be applied to directors of a public company. A Court's decision may be affected by the problem and appropriate consideration for the protection of the interests

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(ii) after making an independent assessment of the information or advice, having regard to the director's knowledge of the corporation and the complexity of the structure and operations of the corporation; and

(c) the reasonableness of the director's reliance on the information or advice arises in proceedings brought to determine whether a director has performed a duty under this Part or an equivalent general law duty;

the director's reliance on the information or advice is taken to be reasonable unless the contrary is proved.

[206] See The *Model Corporation Act 2005* (US) s 8.30 (c)-(e).

[207] Chirachotkachonkun, above n 203, 159.

of the company may not be given. One reason, as noted above, is that no cases have been brought to the Thai Supreme Court concerning a dispute of the standard of care to be applied either in a public or a listed company; the reason probably being that the Thai legal system does not pay much attention to the principles of the duty of care being more concerned with black letter law. If the measures or definitions specified in the codes are not clear, the lawyer or plaintiff would not claim damages with respect to that provision. Hence, in the case of insolvent trading, creditors who lose money will not be protected if the provisions in the statutes are not clear.

D *Inadequate Directors' Liabilities*

Directors' duties for conducting a company can attract liability. Thus, if a director's actions are negligent or dishonest, they can breach the law and lead to civil and criminal liabilities for directors. Directors who violate the duty of agency, duty of care or other specific duties may face personal liability. However, proving negligence or dishonesty under Thai legislation is difficult because of problems such as meeting the necessary burden of proof and limitations of claim. This section discusses the directors' liability problems in the Thai jurisdiction, first by discussing the law with regard to the liability of directors, then by discussing the absence of punishment for errors made by company directors.

1 Liabilities of Directors

Company directors may incur a personal liability if they breach the laws in one or more of four ways:

(a) Liability to Company

A company can sue a director who violates duties provided for in the various relevant corporate laws. The court may hold that a director has civil liability or criminal liability.

Civil liability

For private companies, the *CCC* provides for directors' liabilities to the company in ss 1168, 1169 and 420.

Section 1168 of *CCC* states that 'directors must in their conduct of the business apply the diligence of a careful business man.' Therefore, directors must operate the company carefully and diligently. If directors are negligent and their negligence causes damage to the company, the directors would be liable according to s 1169.[208] Section 1169 specifies that only the company or its shareholders would be able to apply for compensation from directors. However, there is a defence for directors who act under the approval of the general meeting, according to s 1170.[209] Directors can claim that, even though there is damage to the company, they cannot be held personally liable, because they managed the company with the approval of the general meeting of shareholders.

Several Supreme Court decisions found that a claim under s 1169 by the company is limited. For instance, in the case no 4549/2540, the court ruled that, in a case where the company requests a remedy under s 1169 para 1 of *CCC*, loss or damage to the company must directly result from the directors actions. If the loss or damage is not directly attributable to the directors, they are not liable to compensate for the damage which occurred to the company. Five years after that decision, the court upheld this ruling in a similar case:[210] directors will be liable to the company, pursuant to s 1169 of the *CCC* only in the case that the damage to the company was direct damage which occurred as a result of the directors' act or omission to act. Therefore, the company cannot request any remedy under s 1169 for indirect damage arising from directors' actions.

In respect of tort, the company can claim damages under s 420 of *CCC*.[211] This section provides a claim for an injured person, whether a creditor, a shareholder or even a

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[208] *CCC* s 1169 provides: 'Claims against the directors for compensation for injury caused by them to the company may be entered by the company or, in case the company refuses to act, by any of the shareholders.'

[209] *CCC* s 1170 states: 'When the acts of a director have been approved by a general meeting, such director is no longer liable for the said acts to the shareholders who have approved them, or to the company.'

[210] See Thai Supreme Court case no 3371/2545.

[211] *CCC* s 420 provides: 'A person who, wilfully or negligently, unlawfully injures the life, body, health, liberty, property or any right of another person, is said to commit a wrongful act and is bound to make compensation therefor.'

company, to sue directors who cause damage through an intentional or negligent act. However, s 420 of the *CCC* holds only persons who act tortiously are liable. Chantara-opakorn thus maintains that 'the rights referred to in s 420, accordingly, do not include the right voluntarily or intentionally established by persons which is a contractual right.'[212] In fact, an allegation in the business line under s 420 of the *CCC* is difficult for injured persons to prove as they rarely have access to enough evidentiary documents or are aware of the processes used by directors to show that they acted dishonestly or negligently. Therefore, there are only a few cases where a director was sued by a claim under s 420.

With regard to a public limited company, the *PLC* also provides civil directors' liabilities to the company in ss 85 para 2,[213] 86 para 2[214] and 91.[215] However, there are

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[212] Oranat Chantara-opakorn, *Directors' Responsibilities and Liabilities in Insolvency and Pre-Insolvency Cases* (LLM Thesis, Thammasat University, 2012), 43-44.

[213] *PLC 1992* s 85 para 2 states:

> In the case where any director performs any act or does not perform any act, which fails to comply with paragraph one, the company or the shareholders, as the case may be, may proceed as follows:
>
> (1) if such act or omission causes damage to the company, the company may claim compensation from such director.
>
> In the case where the company fails to make such claim, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold of the company may issue a written notice directing the company to make such a claim. If the company fails to take action as directed by the said shareholders, such shareholders may bring a suit to the court to claim compensation on behalf of the company;
>
> (2) if such act or omission is likely to cause damage to the company, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold of the company may apply to the court to order that such act be settled.

[214] *PLC 1992* s 86 para 2 provides: 'In the case where a director violates paragraph one, the company may claim compensation for damage caused by such director, provided the suit shall be brought to court within one year of the date of notice of such violation and not more than two years from the date of the violation.'

[215] *PLC 1992* s 91 specifies:

> The directors shall be jointly liable for any damage to the company in the following cases:
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> (1) the calling for subscribers to make payment on subscription of shares or to transfer the ownership of the property to the company in a manner that does not comply with s 37 or s 38;
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> (2) the spending of money for the payment on shares or the disposal of property received in payment on shares of the company in a manner which violates s 43;
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> (3) the performing of any act in violation of s 85;
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> (4) the granting of a loan in violation of s 89;
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> (5) the payment of money or giving of other property to a director which does not comply with s 90;
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> (6) the payment of dividends to shareholders which violates s 115, or being liable under s 118, unless proven that such act was performed in good faith and based on the evidence or financial reports certified to be accurate by the chairman of the board or a financial officer of the company or an auditor;

defences for directors under ss 92[216] and 95. For example, if directors can prove that any act performed by them has been authorized, approved or ratified by a resolution of the shareholders' meeting, they shall not be liable to the company, shareholders or creditors for such an act.[217]

The *SEA* provides that directors will be liable if they cause any damage to the company under ss 89/18 and 89/19. These sections provide rights to the company for claiming damages resulting from violations of directors' duties. Moreover, directors in a listed company cannot make a claim that their actions were approved or ratified by a shareholders' meeting or the board of directors in the same way as directors in a public company can, as specified in the *SEA* s 89/21.

It is remarkable that directors of all types of companies have no civil personal liability to the company for mismanagement leading to the company's insolvency. In the context of insolvent trading, directors should have civil personal liability for mismanagement even if they had no intention to defraud the company. The carelessness or negligence of directors should be a way for a company to claim that directors are personally liable.

Criminal liabilities

Besides the civil liability of directors who breach the laws as mentioned above, directors in a private limited company can be held to be criminally liable in certain circumstances, for example when making a false statement, as specified in the *Act Determining Offences relating to the Register Partnership, Limited Partnership,*

(7) the failure to prepare or keep accounts, registers or documents of the company in accordance with this Act, unless proven that they have taken reasonable action to avoid such violation.

[216] *PLC 1992* s 92 states:

The directors shall not be liable under s 91 in the following cases:

(1) having proven that they did not participate in such act or it was done without a resolution of the meeting of the board of directors;

(2) having objected at a meeting of the board of directors, and such objection appears in the minutes of the meeting or the objection was made in writing and submitted to the chairman of the meeting within three days as from the date of the meeting.

[217] *PLC 1992* s 95 provides that: 'Any director who has performed any act which has been authorized, approved or ratified by a resolution of the meeting of shareholders, notwithstanding that such resolution may later be cancelled, shall not be liable to the company, shareholders or creditors of the company for such act.'

Limited Company, Association, and Foundation BE 2499 (1956). This Act provides liabilities for directors and persons who have responsibility in carrying out the business of a private limited company. For example, if a director makes a false statement in bad faith or conceals the truth relating to the financial status of the company from the general meeting, the director may be fined.[218] Furthermore, directors will be liable if acting in bad faith is identified, provided for in ss 39, 40, 41 and 42.[219] There are, in addition, liabilities for directors who operate a company illegally according to the *Criminal Code (1956)*; for example, directors would be punished if they committed an offence of cheating against creditors.[220]

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[218] The *Act Determining Offences relating to the Register Partnership, Limited Partnership, Limited Company, Association, and Foundation BE 2499 (1956)* s 38 provides that: 'A director or a liquidator of the limited company who, in bad faith, makes false statement or conceals the truth relating to financial status of the company to the general meeting shall be liable to a fine not exceeding fifty thousand Baht.'

[219] Ibid s 39 states: 'Any person having responsibility in the carrying out of business of the registered partnership, limited partnership, or limited company who takes away, causes damage, destroys, vitiates, or renders useless property which such juristic person pledged to the pledgee, and such act causes damage to the pledgee, shall be liable to imprisonment for a term not exceeding three years, or to a fine for not exceeding sixty thousand Baht, or to both'; and s 40 states:

'Any person having responsibility in the carrying out of business of the registered partnership, limited partnership, or limited company who knows whether the creditor of such juristic person, or the creditor of other persons performing as the creditor of such juristic person, institute or is going to institute his or her claim to the Court, and, with an intention to cause damage to the creditor:

(1) move, conceal, or transfer to other persons of property of such juristic person; or

(2) make such juristic person to have unreal obligation,

The person shall be liable to imprisonment for a term not exceeding three years, or to a fine for not exceeding sixty thousand Baht, or to both';

s 41 provides: 'Any person having responsibility for the carrying out of business of the registered partnership, limited partnership, or limited company who, for unlawful benefit of him or her or other persons, acts or refrains from acting something which cause damage to such juristic person shall be liable to a fine for not exceeding sixty thousand Baht; s 42 states: 'In the case where a person who is responsible for the carrying out of business of the registered partnership, limited partnership, or limited company, acts or consents to act, with an intention to deceive partnership, company, each partner of partnership, or shareholders about their untrue benefits, whereby such acts:

(1) cause damage, destroy, change, cut off, or falsify of the accounts, documents, or securities of the partnership or company or in relating to the partnership or company ;

(2) make false statements or omit to record important substances in the accounts or documents of partnership or company or in relating to the partnership or company,

The person shall be liable to imprisonment for a term not exceeding seven years, or to a fine for not exceeding one hundred and forty thousand Baht, or to both.'

[220] See the *Criminal Code (1956)* ss 349-351.

The standard of proof is, however, problematic. Section 227 of the Thai *Criminal Procedure Code BE 2477 (1934)*[221] gives the benefit of doubt to an offender, and requires a prosecutor or a plaintiff to prove, beyond reasonable doubt, that the offender's intention was to work dishonestly. It is very difficult for a plaintiff to prove, beyond reasonable doubt, that there was a guilty intention on the part of directors. To solve the problem, especially in the case of insolvent trading, it is probably more appropriate to require the same standard of burden of proof as that applied in civil or commercial cases, that is, on the balance of probabilities, in order to prove that the business conducted by a director while the company was insolvent was legal or not.

In relation to a public limited company, criminal liabilities identified in the *PLC* can be classified into two categories: fine and imprisonment. Criminal liabilities for directors can be separated into three types:

1. Criminal liabilities for any board of directors – according to ss 195-197 of the *PLC*, any board of directors which fails to comply with other sections identified in the *PLC (1992)*, such as ss 74, 75 and 79, will have fine and imprisonment liabilities.

2. Criminal liabilities for any directors – any director may be fined or imprisoned for contravening ss 203[222] and 214.[223]

3. Joint criminal liability for directors and a company – s 222 of the *PLC (1992)* provides that:

   'In the case where the company is the offender and is liable to penalty under this Act, any director who connives at the commission of such offence or who

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[221] The *Criminal Procedure Code BE 2477 (1934)* s 227 states: 'Where any reasonable doubt exists as to whether or not the accused has committed the offence, the benefit of doubt shall be given to him.'

[222] *PLC 1992* s 203 provides that: 'Any director who fails to comply with s 88 or does comply with s 88 but incompletely or inaccurately as to truthfulness shall be liable to a fine not exceeding twenty thousand Baht.'

[223] *PLC 1992* s 214 states that: 'Any director or liquidator of a company dishonestly making any false statement or concealing any fact which should be clearly notified to the meeting of shareholders and which is related to the financial condition of that company shall be liable to a fine not exceeding fifty thousand Baht.'

does not reasonably attempt to prevent the commission of such offence shall be liable to punishment imposed for such offence.'

The reason that directors shall be jointly liable with the company is that the company cannot commit an offence by itself. The directors are the persons who are the directing mind and will of the company. Therefore, directors shall be liable jointly with the company on two conditions:

- the company is the offender and is liable to penalty under this Act
- a director connives at the commission of such offence or does not reasonably attempt to prevent the commission of such offence.

However, as noted above concerning the criminal liabilities of directors, there are problems with proving directors' liabilities, especially in the context of insolvent trading:

1. The fine imposed in the *PLC (1992)* is quite a small amount of money and is unlikely to act as a deterrent on directors' behaviours. For example, s 214 of the *PLC (1992)* stipulates that there is a fine not exceeding THB50 000 for dishonest directors who have made any false statement or concealed any fact which should have been provided to shareholders.
2. The *PLC (1992)* does not have any prohibitive measures to prevent directors who previously operated a series of insolvent companies from setting up a new company under a new name, whether directly or indirectly. This means that directors can set up a new company or be a director of a new company easily to avoid any liability to the creditors of a previously failed company.[224]

In listed companies, directors will be liable if they breach a duty of care according to s 89/7. There is a fine for directors imposed by s 281/2.[225] Directors must pay a fine of

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[224] Sungkom Horharin, *Legal Problems in Registration of Legal Entity and Legal Measure to Punish the Board of Directors in the Event of Bankruptcy: A Study of the Case of the Limited Liability Company and the Public Limited Liability Company* (LLM Thesis, Ramkhamhaeng University, 1998), 181.

[225] *SEA* s 281/2 provides:

not less than THB500 000. However, liability under this section is dependent of actual damage being caused. If there is no actual damage, directors are not liable. Moreover, in the case where the damage which occurred is less than THB500 000, directors must still pay the THB500 000. The company cannot make any exceptions with regards to directors who breach this duty; the exceptions made are invalid.[226]

Directors also face criminal liabilities. For example, directors will be held liable for not notifying related interest or a related person's interest in relation to management of the company pursuant to s 89/14.

S 281/3 of the *PLC* provides:

> Any director or executive of the company who fails to comply with S 89/14 shall be liable to a fine not exceeding five hundred thousand Baht and a further fine not exceeding three thousand Baht for every day during which the contravention continues.

Therefore, there is a fine for directors who violate the duty to provide information under s 89/14. Any exception or contract entered into by the company with a director who violates s 89/14 is invalid.[227]

Moreover, if there is evidence that directors operated the company dishonestly, there are other criminal sanctions, such as imprisonment or confiscation of property to punish directors according to s 281/2 para 2 under the *SEA* and the *Criminal Code (1956)*.

'Any director or executive of the company who fails to perform his duties with responsibility, due care and loyalty in accordance with s 89/7 which causes damage to a company or causes himself or another person to obtain any benefit from the contravention or failure to comply with such duties shall be liable to a fine not exceeding the damages or the benefit obtained but not less than five hundred thousand Baht.

In cases where a person who commits an offence under the first paragraph with dishonest intent, he shall be liable to imprisonment for a term not exceeding five years and a fine not exceeding two times the damages incurred or the benefit obtained but not less than one million Baht, or both.'

[226] Chirachotkachonkun, above n 203, 82.

[227] Ibid, 83.

Nevertheless, in the case of insolvent trading, criminal liabilities imposed in laws under the Thai jurisdiction are not efficient enough to deal with the insolvent trading problem. The significant issue is the burden of proof where a plaintiff must prove beyond a reasonable doubt that the director's management of a company was conducted dishonestly. Thus, evidentiary burden for criminal liability or shifting the burden of proof to directors in order to deal with the insolvent trading problem is necessary.

(b) Liabilities to Shareholders

Directors have a duty to shareholders as a whole because they have been appointed by shareholders and, therefore, have the consent and trust of shareholders. Directors must have the abilities and knowledge to operate the company. This can imply that directors shall run the company business according to the objectives and regulations of the company, as well as the law. Thus, directors have duties and liabilities to shareholders directly. If directors ignore, spite or use their power excessively in ways which lead to damage to shareholders, shareholders have rights to sue the directors. Horharin claims that, normally, liabilities are applicable to an individual director. A director who damages a company will be liable for only himself. Other directors will not have liabilities if they do not connive in the activity causing damage to shareholders.[228] However, in some cases directors have joint liabilities such as duties provided for in ss 1112[229] and 1168 of *CCC*.

Civil liability

With regard to a private company, the *CCC* provides shareholders' rights to request a remedy in only three sections: ss 1168, 1169 and 420, as noted above. For instance, according to s 1168 para 2,[230] directors have joint liabilities to ensure that the shares of

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[228] Horharin, above n 224, 22; see also Thai Supreme Court case no 1908/2519. The court ruled that a director who has no duty in operating the company will not be jointly liable for indirect damages caused by another director who intentionally or negligently caused damage.

[229] *CCC* s 1112 concerns the situation when a company is not formed within three months after the statutory meeting. Directors then have a duty to repay all money to shareholders. If any such money has not been so repaid within three months, the directors of the company are jointly liable to repay that money with interest from the expiration of the three months.

[230] *CCC* s 1168 para 2 provides:

shareholders are actually paid. If there is damage to shareholders, these can claim their damages via s 1169. However, the problems of these sections are the same as with the company's claim. Shareholders can also claim for damages under s 420 of the *CCC*, but also face the same evidentiary problems as already highlighted.

Arguably, the sections are not provided for in the case of insolvent trading. Consequently, directors' liabilities under the *CCC* are not sufficient to deal with the insolvent trading problem.

A shareholder in a public company can sue directors for compensation pursuant to the *PLC (1992)* s 85 para 2.[231] However, according to the Thai Supreme Court case no 175/2506 (1963), a company or a shareholder can sue directors only in cases where directors acted dishonestly or negligently. Directors can be sued by a shareholder in the case of the company not claiming compensation, and the compensation reimbursed will be returned to the company only, not to the shareholder. That means a shareholder cannot sue directors in self-interest.[232] Singhaviriya opines that if directors operate a company in compliance with all laws, regulations, company's articles and so on, and

'In particular they are jointly responsible:

(1) For the payment of shares by the shareholders being actually made;
(2) For the existence and regular keeping of books and documents prescribed by law;
(3) For the proper distribution of the dividend or interest as prescribed by law;
(4) For the proper enforcement of the resolutions of the general meetings.

[231] *PLC 1992* s 85 para 2 states:

> In the case where any director performs any act or does not perform any act, which fails to comply with paragraph one, the company or the shareholders, as the case may be, may proceed as follows:
>
> (1) if such act or omission causes damage to the company, the company may claim compensation from such director.
>
> In the case where the company fails to make such claim, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold of the company may issue a written notice directing the company to make such a claim. If the company fails to take action as directed by the said shareholders, such shareholders may bring a suit to the court to claim compensation on behalf of the company;
>
> (2) if such act or omission is likely to cause damage to the company, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold of the company may apply to the court to order that such act be settled.

[232] See Thai Supreme Court case no 175/2506.

there is still damage affecting the company, neither the company nor shareholders have the right to request compensation from directors.[233]

The company can sue a director who causes damage to the company. In a case where the company fails to make such a claim, any one or more shareholders who hold shares amounting to not less than five per cent can send a notice to the company or sue the directors for compensation on behalf of the company according to s 85 para 2 of the *PLC (1992)*.[234] Based on the information provided by the Thai Supreme Court website, however, there is no case dealing with requesting a remedy under s 85 of the *PLC (1992)*.[235] Shareholders who hold shares of not less than five per cent of the total number of shares, may nevertheless apply for a court order for the removal from office of such directors who damage the company according to s 85 para 3 of the *PLC (1992)*.[236]

Shareholders may take legal action against directors with regard to a breach of duty to avoid conflicts of interest under s 86 para 3.[237] Nevertheless, there is a condition

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[233] Singhaviriya (2010), above n 81, 148.

[234] *PLC 1992* s 85 para 2 specifies:

> 'In the case where any director performs any act or does not perform any act, which fails to comply with paragraph one, the company or the shareholders, as the case may be, may proceed as follows:
>
> (1) if such act or omission causes damage to the company, the company may claim compensation from such director.
>
> In the case where the company fails to make such claim, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold of the company may issue a written notice directing the company to make such a claim. If the company fails to take action as directed by the said shareholders, such shareholders may bring a suit to the court to claim compensation on behalf of the company;
>
> (2) if such act or omission is likely to cause damage to the company, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold of the company may apply to the court to order that such act be settled.'

[235] Information based on the search engine provided by the Supreme Court website as of 1 February 2016 at <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

[236] *PLC 1992* s 85 para 3 provides that: 'In the case where the shareholders are the persons who proceed under paragraph two, they may also apply for a court order for removal of such director from office.'

[237] *PLC 1992* s 86 para 3 states that:

In the case where the company fails to exercise the rights under paragraph two, any one or more shareholders holding shares amounting to not less than five percent of the total number of shares sold may by written notice direct the company to make such a claim. If the company fails to proceed as directed by the shareholders within one month as from the date of the notification, or if less than one month of the period of prescription under paragraph two remains, the said shareholders may exercise the rights on behalf of the company and the provisions of s 85 paragraph two (2) and paragraph three shall apply mutatis mutandis.

specified in this section. A shareholder or shareholders who hold shares less than five per cent of the total number of shares cannot have this right to sue directors even if they breach the duty to avoid conflicts of interest. This means that the protection offered by the law does not cover the interests of minority shareholders with less than five per cent of the company's shares.

Moreover, when any damage caused by directors has occurred and affects shareholders and persons concerned with the company, the directors will be liable to the shareholders pursuant to s 94 of the *PLC (1992)*. However, there is a defence for directors to avoid personal liability if their acts are approved or authorised by a resolution of the shareholders' meeting, according to s 95 of the *PLC (1992)*.[238]

With regard to shareholders' rights in a listed company, shareholders can claim their damages according to ss 89/18[239] and 89/19[240] if directors breach their duty of loyalty and duty of care pursuant to s 89/7. Directors have a civil liability to shareholders for any damages occurring because of a breach of directors' duties. However, there is a condition that a shareholder or shareholders shall hold shares and have the right to vote

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[238] *PLC 1992* s 95 indicates that:

Any director who has performed any act which has been authorized, approved or ratified by a resolution of the meeting of shareholders, notwithstanding that such resolution may later be cancelled, shall not be liable to the company, shareholders or creditors of the company for such act.

[239] The *Securities and Exchange Act B.E. 2535* (Thailand) s 89/18 specifies that:

In addition to the action brought against a director under S 85 and S 86 of the Public Limited Companies Act B.E. 2535, in cases where the director acts or omits to act in such a way that constitute non-compliance with S 89/7 which causes the director, the executive or the related person to obtain undue benefits, the company may bring an action against the director for disgorgement of such benefits to the company.

In cases where a shareholder or shareholders who hold shares and have the right to vote amounting to not less than five percent of the total number of voting rights of the company have issued a written notice directing the company to bring the action under the first paragraph and the company fails to proceed as directed within one month from the date of the notice, such shareholder or shareholders may bring an action for disgorgement of benefits under the first paragraph on behalf of the company.

In cases where the shareholder or shareholders bring the action under this S on behalf of the company, if the court is of the opinion that the action is brought by the shareholder or shareholders in good faith, the court shall be empowered to order the company to compensate the said shareholder or shareholders for actual expense as the court thinks fit; in this regard, for the purpose of determining such compensation, the court shall be empowered to order the company to be a party in the case.

[240] The *Securities and Exchange Act B.E. 2535* (Thailand) s 89/19 provides that: 'The provision of S 89/18 shall apply to the case against an executive to act or omit to act in such a way that constitute non-compliance with his duty under S 89/7 or to disgorge undue benefits obtained by him or the director or related person, mutatis mutandis.'

amounting to not less than five per cent of the total number of voting rights of the company. If a shareholder does not or shareholders do not hold five per cent of the total number of shares, they cannot rely on this right to claim damages. This means that a minority shareholder, especially a person who holds a small amount of all shares, does not have the same legal protection as a majority shareholder. So, in this case, shareholders have only one way to claim damages, and that is by applying s 420 of *CCC*. However, it is very difficult for minority shareholders to achieve success.

Like the corporation, shareholders cannot claim any damages from directors who fail to appropriately manage the company, especially when the company approaches the state of insolvency. There is not even a duty or liability of directors to shareholders. This is an important issue for the case of insolvent trading. Directors should be liable to shareholders if they manage the corporation carelessly or negligently.

Criminal liability

As in the case of rights of the corporation, shareholders have rights to claim for damages from a private company. However, shareholders face the same problems regarding directors' criminal liability as corporations do; the burden of proof being the main problem.

With regard to rights to claim damages from directors of a public company, surprisingly, the *PLC (1992)* contains no provisions concerning directors' criminal liabilities in the case of damages inflicted on shareholders from mismanagement. For example, even if directors violate their duty of care as provided in s 85, no criminal liability arises under the *PLC (1992)*. However, it may be possible to hold directors liable under the *Criminal Code (1956)* if they operate a company dishonestly.

Shareholders of a listed company can also sue directors for criminal liability according to the *Criminal Code (1956)*. Furthermore, ss 89/18 and 89/19 of the *SEA* provide shareholders with the right to hold directors' criminally liable in the case of dishonest action, though shareholders must hold more than five per cent of the company's shares to do so.

(c) *Liability to Creditors*

Civil liability

Thai corporate laws provide many penalties when directors breach laws. However, creditors have only a few options when making claims. Creditors may make claims under ss 1169 and 420 of the *CCC* for damages, but creditors face the same problems with these sections as already discussed above. The *CCC* provides a defence to directors in s 1170 to avoid personal liability.

Creditors might sue using laws regarding contractual relationship or agreements but, if directors manage a corporation as approved by a general meeting or the company's regulations, they are not personally liable. Directors do have personal civil liability if they use their power *ultra vires* as specified in the company registration or regulations of the company. But, in terms of insolvent trading, a contractual relationship between creditors and directors cannot be claimed for any remedy if directors operate a business as approved by a general meeting of shareholders or according to the company's regulations and if they do not exercise their power *ultra vires*.

Directors have joint liability to creditors according to s 94 of the *PLC* in public companies.[241] However, any director who has performed any act which has been authorised, approved or ratified by a resolution of a meeting of shareholders cannot be held liable by creditors.[242]

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[241] *PLC 1992* s 94 provides:

> 'The directors shall be jointly liable for any damage to the shareholders and persons concerned with the company in the following cases, unless proven that they had no part in such wrongdoing:
> (1) giving false information or concealing any information that should be disclosed about the financial condition and business operation of the company in the offer for sale of shares or debentures or other financial instruments of the company;
> (2) presenting or filling out a document submitted to the Registrar containing false information or particulars which does not correspond to the accounts, registers or documents of the company;
> (3) preparing a false balance sheet, statement of profit and loss, minutes of a meeting of shareholders or minutes of a meeting of the board of directors.'

[242] *PLC 1992* s 95 specifies: 'Any director who has performed any act which has been authorized, approved or ratified by a resolution of the meeting of shareholders, notwithstanding that such resolution may later be cancelled, shall not be liable to the company, shareholders or creditors of the company for such act.'

The *SEA* provides for creditors of listed companies to claim for losses only under s 89/20, which provides joint liability for disclosure of information to shareholders or the public which contains a false statement or conceals material facts; that is directors and executives have joint liability regarding disclosure of information which contains a false statement or conceals material facts.[243] Nevertheless, directors' bad faith in their management is difficult to prove.

When the company approaches insolvency, management should consider creditors' interests as a priority. Current Thai laws, however, do not sufficiently support creditors' interests and the weak capacity to hold directors liable contributes to the problem of insolvent trading, particularly in the case of creditors' interests. There are only a few rules under which creditors can claim for damages and there are many defences for directors to avoid personal liabilities.

Criminal liability

Directors have personal liability to creditors only if they operate a corporation dishonestly or with fraudulent intention. In other words, without fraud or bad faith directors cannot be held criminally labile. Creditors have to face the burden of a high standard of proof to sue for criminal liability.

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[243] *PLC 1992* s 89/20 states:

> 'The directors and the executives shall be jointly liable to a person who traded securities of the company for any damages arising from disclosure of information to shareholders or the public which contains a false statement or concealing material facts which should have been stated in the following cases, unless the directors or the executives can prove that, by his position, he could not have been aware of the truthfulness of information or lack of information which should have been stated:
>
> (1) providing information in support of seeking a resolution of the shareholders' meeting;
>
> (2) financial statements and reports concerning the financial condition and the business operation of the company or any other reports required to be disclosed under S 56, S 57, S 58 or S 199;
>
> (3) an opinion of the business when a person makes a general tender offer to purchase shares from shareholders;
>
> (4) providing information or any other reports in relation to the business prepared by the company for the purpose of disclosure to shareholders or the public as specified in the notification of the Capital Market Supervisory Board.
>
> In bringing an action to claim for the damages under the first paragraph, no action shall be brought to the court upon lapse of two years from the date on which the injured person has been aware of the disclosure of a false statement or the concealment of facts under the first paragraph or five years from the date on which such act has been committed.

(d) Liability to Third Parties

As already explained, a director is a representative and agent of the company. All acts of the director in managing the company according to the company's objects or regulations act as a legal shield to protect the director from liability. This means that the director is not personally liable to a third party if he manages the company pursuant to the company's regulations, objects and a resolution of a general meeting of shareholders.[244] However, if a director enters into an agreement or does something beyond the powers provided to him in the objects or regulations, he become personally liable if the company does not benefit from or ratifies the agreement, under s 1167 of the *CCC*.[245] Moreover, the company may be liable to make compensation for losses resulting from the company directors' work as representatives, agents or ostensible agents of the company. Therefore, third parties usually attempt to involve the company in damages cases because there is a greater possibility of obtaining a remedy from the company than from the directors.

Generally, directors have no civil and criminal liability to a third party if directors operate the corporation according to the objects or regulations of the company. This is also the case with directors who fail to stop a company from engaging in insolvent trading.

It is remarkable that directors in Thailand are not personally liable to the company under their management as long as they act in accordance with the laws and within the objects of the company. Nor do they owe any specific duty to individual shareholders and creditors, especially in the case of company insolvency. If directors operate the corporation in good faith, there is no liability owed by directors. Creditors, shareholders or the company should have a remedy from directors, particularly when the company becomes insolvent and directors continue to mismanage the company through carelessness or negligence. Mismanagement by directors of a company may lead to creditors facing severe financial problems. For these reasons, Thai laws need to be reformed to protect related persons' interests, particularly in the case of insolvent

[244] Horharin, above n 224, 24.
[245] See Thai Supreme Court's decision no 1725/2513.

trading. A specific provision imposing liability on directors to deal with the problem of insolvent trading is needed for the optimal functioning of the Thai economic system.

2 Absence of Remedies when Company Directors' Fail to Prevent Insolvent Trading

As explained previously, the Thai laws regulating a private company, a public company and a listed company are not efficient enough to protect the interests of the company, shareholders, creditors or third parties, particularly in the matter of insolvent trading. There is no specific provision that imposes a duty on directors to prevent insolvent trading. For this reason, directors have no personal liability for damages caused to the company and others by insolvent trading. The severity of the matter is reflected in the statistics relating to the workload of the Central Bankruptcy Court of Thailand. Between 1999 and 2011 statistics show that corporate insolvencies were increasing.[246] There were only 416 cases of insolvencies in 1999, but 18 525 cases in 2009. In addition, the amount of assets of affected companies has increased from THB10 148 739 788 in 1999 to THB388 620 032 442 (approximately A$ 388 291 326 to A$ 12 954 001 081) in 2009. In the last two years, these figures have grown even more, with 22,874 insolvency cases and a total asset amount THB727 389 011 823 (approximately A$ 24 246 300 394). Insolvency, thus, impacts a significant number of companies in Thailand, with the result that most of these companies cease to operate, impacting both employees and creditors. Obviously this has an adverse impact on Thailand's ability to attract both Thai and foreign investors.

Both the principal laws controlling private, public and listed companies and specific laws related to regulating companies are inadequate to deal with insolvent trading. Naturally, when a company faces difficult financial circumstances, the directors will take action to recover the financial status of the company. It is possible that, in spite of the directors' efforts, the company will, nevertheless become insolvent; the reasons may be any one of a combination of director's lack of experience to operate the

[246] The Central Bankruptcy Court, *Statistics of Case Law and Asset Sued in the Central Bankruptcy Court between 18 June 1999 and 30 November 2011* <http://www.cbc.coj.go.th/userfiles/file/st003.pdf>.

company, global financial conditions or insolvent trading. Significantly, when a company is insolvent, third parties are affected. The *Bankruptcy Act* (1940) was introduced in Thailand to solve the many problems that result from insolvency.

Bankruptcy, however, is the final stage of company insolvency. Trading while insolvent can also have detrimental effects, impacting on properties or company finances.

As explained, the Thai *Bankruptcy Act (1940)* was influenced by the English bankruptcy law and aims to collect all the debtor's properties and allocate them *pari passu* to all creditors.[247] However, the present *Bankruptcy Act* does not impose duties and liabilities on directors when the company is sued for trading while it is insolvent, and when directors make errors in management which lead to insolvency. The *Bankruptcy Act (1940)* does assign responsibility to directors when the Bankruptcy Court officially finds the company insolvent.

[247] Mahakhun, above n 56, 1-2.

A Thai company is officially insolvent when it cannot pay its debts as defined by s 8 of the *Bankruptcy Act (1940)*.[248] Section 9[249] of the Act states that the conditions involving suing a company for bankruptcy are composed of two parts: cases in which a company is unable to pay its debts, and in which there are debts of more than two million Baht.

The *Bankruptcy Act (1940)* can be divided into two main parts: the first part consists of rules, procedures of accusation and bankruptcy proceedings; and the second part includes rules and procedures for the rehabilitation of debtors.[250] However, neither part includes a law which imposes a duty on directors to prevent insolvent trading. If,

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[248] The *Bankruptcy Act 1940* s 8 states:

'If there occurs any of the following circumstances, it shall be presumed that the debtor is insolvent:

(1) the debtor transfers his property or the right to its management to any other person for the benefit of all of his creditors, whether such act is carried out within or outside the Kingdom;

(2) the debtor transfers or delivers his property with fictitious intent or by fraud, whether such act is carried out within or outside the Kingdom;

(3) the debtor transfers his property or creates over such property any right in rem which, where the debtor is bankrupt, shall be deemed as favourable, whether such act is carried out within or outside the Kingdom;

(4) the debtor carries out any of the following acts for the purpose of delaying payment or preventing a creditor from receiving payment of the debt:

a. leaving the Kingdom or having left the Kingdom and remaining outside the Kingdom;

b. leaving the dwelling place where he resided or concealing himself in a dwelling place or absconding by any other means or closing his place of business;

c. diverting the property out of the jurisdiction of the Court;

d. allowing himself to be subjected to a judgment compelling payment of money which he ought not to make;

(5) the debtor is subject to seizure of property under a writ of execution or has no property susceptible of seizure for payment of the debt;

(6) the debtor makes to the Court a declaration, in any action, of his inability to pay the debt;

(7) the debtor makes a notification to any of his creditors of his inability to pay the debt;

(8) the debtor makes a debt composition proposal to at least two creditors;

(9) the debtor has received from the creditor a letter of demand at least twice with an interval of not less than thirty days and the debtor has failed to make payment of the debt.'

[249] The *Bankruptcy Act 1940* s 9 provides:

'The creditor may initiate a bankruptcy action against the debtor only if:

(1) the debtor becomes insolvent;

(2) the debtor who is a natural person is indebted to one or more plaintiff creditors in an amount of not less than one million Baht or the debtor who is a juristic person is indebted to one or more plaintiff creditors in an amount of not less than two million Baht; and

(3) the definite amount of such debt is determinable, whether it becomes due forthwith or at a future date.'

[250] Horharin, above n 224, 165.

however, the company is declared insolvent, the directors face liabilities depending upon whether:

- The company is declared bankrupt by a court;
- The company is ordered to be rehabilitated by a court.[251]

First, in the case where a company is pronounced bankrupt by the court, the Thai *Bankruptcy Act (1940)* s 61[252] does not allow the name of the director who managed the company business and under whom the company collapsed to be made known. The director's name is not to be mentioned in a newspaper or the government gazette. Thus, a third party is not able to determine the director's management experience. Moreover, there is no law to prohibit this director from setting up a new company. If the director sets up a new company and those in the new company or the third party fail to recognise the director's former involvement in a bankrupt company, then it is possible for a new company and third party to obtain damages from the director.[253]

However, a director is not provided with any sanction in the case that a company is ordered to rehabilitate by the court. When the court orders the company to be reorganised, a director has no immediate power to manage the company business. If the reorganisation plan is unsuccessful, the director falls under the same rule as explained in the paragraph above. If the plan is successful, the power to manage the company returns to the directors as specified in s 90/75.[254] Therefore, with regard to

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[251] Ibid.

[252] The *Bankruptcy Act B.E.2483* (1940) (Thailand) s 61 states that:

When the Court has issued an absolute receivership order against the debt or/and the Receiver has reported that the creditors, at the first meeting of creditors or at the adjourned meeting, passed a resolution requesting the Court to adjudge the debtor bankrupt or passed no resolution or that no creditors attended the meeting or that the composition in satisfaction of debts failed to be approved, the Court shall adjudge the debtor bankrupt and the Receiver shall thence have the power to manage the bankrupt's property for distribution amongst all creditors.

The Receiver shall publish the adjudication in the Government Gazette and in at least one daily newspaper. The publication shall indicate the name, address and occupation of the debtor as well as the date of the adjudication by the Court.

[253] Horharin, above n 224, 166.

[254] The *Bankruptcy Act 1940* s 90/75 states:

> The order terminating the business reorganization shall result in the debtor being free from all debts repayment of which may be applied for in the business reorganization, except for the debts repayment of which has actually been applied for by the eligible creditors in the business reorganization. This order shall also have the following effects:

reorganisation, the important issue is that the law does not provide for sanctioning of directors who fail to carry on the company business. Reorganisation is a plan that helps directors to recover the company's financial status. Because of the absence of punishment and sanction, it is not surprising that directors will not be afraid to take risks with the company's business which may eventually lead to the company's collapse.

Therefore, the *Bankruptcy Act (1940)* does not provide adequate protection for creditors by imposing a duty on directors not to engage in insolvent trading. It can be argued that the *Bankruptcy Act* does not impose any liabilities on directors who failed to manage the company. In fact, there is a measure to help directors to reorganise. Thus, directors may not feel obliged to protect creditors' interests even if the company might finally become insolvent.

Even though the Thai *Bankruptcy Act (1940)* does not provide specific directors' duties particularly when the company is insolvent, a few sections of the code may provide some protection to creditors, shielding them from fraudulent acts or unfair transfer of assets.

Part 3 of the Thai *Bankruptcy Act (1940)* deals with the effect of bankruptcy in regard to business already completed. The law allows the receiver to file a motion to the court for cancellation of any fraudulent act or unfair transferring of assets to preferred creditors. For example, s 113 states: 'The Receiver may apply, by motion, to the Court for cancellation of fraudulent acts in accordance with the Civil and Commercial Code.'

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(1) The debtor's executive shall again have the authority to manage the business operation and assets of the debtor.

(2) The debtor's shareholders shall again enjoy their legal rights.

(3) The remuneration for the interim executive, plan preparer, plan administrator, and interim plan administrator and the debts incurred by the receiver, interim executive, plan preparer, plan administrator, or interim plan administrator in reorganizing the business operation of the debtor are, with the exception of debt arising from a wrongful act, debts with a preferential right over the whole assets of the debtor, which debts shall have the same rank as the preferential right with first priority pursuant to S 253 of the Civil and Commercial Code.

The fraudulent act referred to in this section means an act pursuant to s 237 of the *CCC*.[255] However, the only person who can file a motion to the court is the receiver. This means that creditors cannot file a motion by themselves but have a right to ask the receiver to do so for them.[256] Moreover, the receiver must file a motion within the statute of limitations provided in s 240 of the *CCC*.[257] There is, however, confusion about the cancellation time, particularly in the words 'one year from the time when the creditor knew the cause of cancellation'. The Thai Supreme Court has defined the meaning of 'the creditors' in two ways: first, 'the creditors' means the receiver, as shown in Thai Supreme Court case no 1752/2518 and 5002/2536; second, recent court decisions claim that 'all related creditors' means the creditors according to s 240 of the *CCC* as decided in the cases nos 209/2521, 3923/2539, 6514/2550. The problem with the court decisions is that, in some cases, there are many creditors, especially in the case of insolvency and not all creditors will know the cause of cancellation at the same time, which might affect the cancellation process as per *CCC* s 237. It may be better to give such empowerment to the receiver alone.[258]

Section 114 of the *Bankruptcy Act (1940)*[259] also establishes a presumption concerning fraudulent acts which are the subject of the motion for cancellation under s 113. Thus, s 114 is a measure trying to protect creditors by shifting the burden of proof to a debtor or a person enriched by the acts who knew that such acts would be prejudicial to

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[255] The *Civil and Commercial Code* (Thailand) s 237 states that:

The creditor is entitled to claim cancellation by the Court of any juristic act done by the debtor with knowledge that it would prejudice his creditor; but this does not apply if the person enriched by such act did not know, at the time of the act, or the facts which would make it prejudicial to the creditor, provided, however, that in a case of a gratuitous act the knowledge on the part of the debtor alone is sufficient.

The provisions of the foregoing paragraph do not apply to a juristic act whose subject is not a property right.

[256] See Thai Supreme Court case no. 3779/2542.

[257] The *Civil and Commercial Code* (Thailand) s 240 specifies that:

A claim for cancellation cannot be brought later than one year from the time when the creditor knew of the cause of cancellation, or later than ten years since the act was done.

[258] Supanit, above n 92, 200.

[259] The *Bankruptcy Act 1940* s 114 states that:

If the fraudulent acts which are the subject of the motion for cancellation under S 113 arose within the time period of one year before the application for adjudication of bankruptcy and thereafter, or if it is a gratuitous act or the case where the debtor received compensation of a less than reasonable amount, it shall be presumed that the debtor and the person enriched thereby knew that such act would be to the prejudice of the creditors.

creditors.[260] Not only fraudulent acts, but also the transferring of assets and, acts carried out or permitted to be carried out by the debtor can be cancelled if they intend to give undue preference to a creditor, pursuant to s 115.[261] This section is applied by not considering the good faith of creditors, but it focuses on only the intention of a debtor. If it is made by a dishonest debtor to give an advantage to a creditor, that transaction can be cancelled by the court.[262] However, this transfer of assets must be made within three months prior to an application to adjudicate the company as bankrupt; transfers before that three months prior period may be carried out without penalty.

Nevertheless, if any advantageous creditor is an insider of the debtor,[263] the court can cancel the act which was made one year before the application for adjudication of bankruptcy and thereafter.[264] In regard to filing a motion under s 115, the law does not determine the duration of time as provided in s 113 of the *Bankruptcy Act (1940)*. So it

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[260] See Thai Supreme Court case no. 5400/2550.

[261] The *Bankruptcy Act 1940* s 115 provides: 'Upon the filing of a motion by the receiver, the court is empowered to cancel any transfer of asset or any act done or permitted to be done by the debtor during the three months prior to an application to adjudicate him as bankruptcy and thereafter, and with the intention to give undue preference to a creditor.'

[262] See Thai Supreme Court cases nos 1167/2506, 870/2509, 883/2511, 1181/2511 and 2651/2525.

[263] The *Bankruptcy Act 1940* s 6 states:

'"Insider of the debtor" shall mean

(1) a director, manager, managing partner, general partner, person responsible for operation or auditor of the debtor;

(2) a shareholder holding more than five percent(5%) of the total number of issued shares of debtor's business;

(3) the spouse and minor children of the persons under (1) or (2);

(4) an ordinary partnership in which the debtor or the person under (1) or (2) or (3) are partners;

(5) a limited partnership in which the debtor or the person under (1) or (2) or (3) are general partners, or are limited partners having in the aggregate more than thirty percent (30%) of the total contribution of the limited partnership;

(6) a limited company or public limited company in which the debtor or the persons under (1) or (2) or (3) or partnerships under (4) or (5) hold shares which in the aggregate comprise more than thirty percent (30%) of the total number of issued shares of such company;

(7) a limited company or public limited company in which the debtor or the persons under (1) through (6) hold shares which in the aggregate comprise more than thirty percent (30%) of the total number of issued shares of such company;

(8) a director, manager, managing partner, general partner, person responsible for operation or auditor of the ordinary partnership, limited partnership, limited company or public limited company under (4) or (5) or (6) or (7), as the case may be, or the spouse and minor children of such person.'

[264] See Thai Supreme Court case nos: 1487/2513, 681/2519, 109/2522, 2581/2524, 2651/2525, 2722/2528, 716/2530, 106/2536 and 6934/2543.

would be necessary to invoke the general limitation of s 193/30 of *CCC*, which is ten years.[265] However, the main issue of s 115 of the *Bankruptcy Act (1940)* is that the debtor must not give any advantage to some creditors. However, if the debtor did transfer assets or permit something by servitude, that act could not be cancelled even if it was advantageous to the creditor.[266]

These sections of the *Bankruptcy Act (1940)* could be the shield used to protect creditors' interests from fraudulent acts or from the transfer of assets with the intention of giving undue preference to a creditor. However, they are not sufficient to prevent the insolvent trading problem. For example, a claim under s 113 must have occurred because of a fraudulent act which includes dishonest intention, but, in fact, insolvent trading can occur unintentionally and without intentional dishonesty. Therefore, the few provisions in the Act that might protect creditors do not effectively cover all situations that might be involved in insolvent trading.

Significant issues remain; a company's directors have no duty to prevent insolvent trading, and there is no penalty for errors in management. There are definitely a few provisions for protecting the creditors' interests but they occur at the end of a chain of events. A measure to overcome the insolvent trading problem would be to enact a law which provides for a positive duty of directors to prevent insolvent trading, also providing for liabilities and punishment of directors in a case where a director fails to appropriately manage the company, particularly in the case of the duty to prevent insolvent trading.

E *Absence of Directors' Duty when a Company is in an Insolvent State*

In Thailand, a company is either solvent or insolvent. Companies are not considered to be insolvent companies if the Bankruptcy Court has not declared them to be so. Unlike

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[265] Teeravejparakul, above n 95, 326; See also Thai Supreme court case nos: 702-705/2513, 1703/2522 and 853/2534.

[266] Supanit, above n 92, 188; See also Thai Supreme Court case nos: 613/2531, 3179-3180/2524 and 5916/2530.

in developed countries, such as the UK, Australia, US and Germany, companies can be in a state of insolvency, 'insolvent companies', without a court order.

None of the *CCC*, *PLC (1992)* or *SEA* deal with the period in which a company is unable to pay its debts, namely in an insolvent state. Therefore, there is no specific duty for directors in that time and company directors can continue to operate the company regardless of the company's financial difficulties. There is no duty for directors to protect creditors' interests from damages which could occur as a result of a company operating while insolvent. Directors, therefore, can avoid personal responsibility.

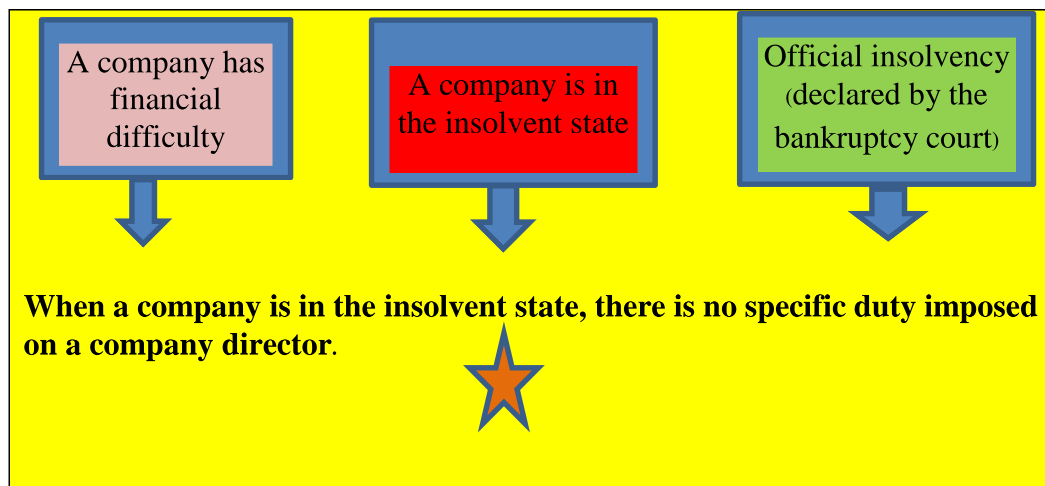

Figure 3.1: Nonexistence of a director's duty in the insolvent state

The *Thai Bankruptcy Act (1940)* provides that 'an insolvent debtor may be adjudged bankrupt'.[267] The company can be sued as insolvent if debts are greater than assets or the company's assets are insufficient to discharge its liabilities.[268] So, the Thai *Bankruptcy Act (1940)* adopts a balance sheet test for determining insolvency. The Act also provides conditions for creditors to initiate a bankruptcy action against the debtor.

[267] The *Bankruptcy Act 1940* s 7.
[268] The *Bankruptcy Act 1940* s 9

There are three significant conditions that creditors must prove under s 9.[269] In addition, the Act determines the presumptions of insolvency as defined in s 8.[270]

The Thai *Bankruptcy Act (1940)*, *CCC*, *PLC* or *SEA*, do not refer to the state of insolvency, even though companies that operate in this state can negatively impact third parties, leaving directors to do so with impunity. The Thai bankruptcy law provides only the presumptions leading to insolvency.

Moreover, according to the Thai bankruptcy law, if the company becomes insolvent but it has debts of less than two million Baht, creditors cannot sue the corporation for bankruptcy because the condition, as provided in s 9, has not been fulfilled. It can be said that, even though there is a relationship between a company and insolvency, this section does not reflect all aspects that should be applied in the case of insolvent trading.

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[269] The Bankruptcy Act *1940* s 9 states: 'Creditors shall show the evidence that (1) the debtor becomes insolvent, (2) the debtor who is a natural person is indebted to one or more plaintiff creditors in an amount of not less than one million Baht or the debtor who is a juristic person is indebted and to one or more plaintiff creditors in an amount of not less than two million Baht; and (3) the definite amount of such debt is determinable, whether it becomes due forthwith or at a future date.'

[270] The *Bankruptcy Act 1940* s 8 provides:

If there occurs any of the following circumstances, it shall be presumed that the debtor is insolvent:

(1) the debtor transfers his property or the right to its management to any other person for the benefit of all of his creditors, whether such act is carried out within or outside the Kingdom;

(2) the debtor transfers or delivers his property with fictitious intent or by fraud, whether such act is carried out within or outside the Kingdom;

(3) the debtor transfers his property or creates over such property any right in rem which, where the debtor is bankrupt, shall be deemed as favourable, whether such act is carried out within or outside the Kingdom;

(4) the debtor carries out any of the following acts for the purpose of delaying payment or preventing a creditor from receiving payment of the debt:

a. leaving the Kingdom or having left the Kingdom and remaining outside the Kingdom;

b. leaving the dwelling place where he resided or concealing himself in a dwelling place or absconding by any other means or closing his place of business;

c. diverting the property out of the jurisdiction of the Court;

d. allowing himself to be subjected to a judgment compelling payment of money which he ought not to make;

(5) the debtor is subject to seizure of property under a writ of execution or has no property susceptible of seizure for payment of the debt;

(6) the debtor makes to the Court a declaration, in any action, of his inability to pay the debt;

(7) the debtor makes a notification to any of his creditors of his inability to pay the debt;

(8) the debtor makes a debt composition proposal to at least two creditors;

(9) the debtor has received from the creditor a letter of demand at least twice with an interval of not less than thirty days and the debtor has failed to make payment of the debt.

The fact that the company cannot pay its debts will affect creditors unless there is a formal insolvency declaration by a court. However, if the company's debts are less than two million Baht, creditors have no right to initiate a bankruptcy action. This is a disadvantage to creditors because the Thai bankruptcy law places greater importance on the total amount of the debts, making it a prerequisite for a bankruptcy suit, than on the impact of insolvent trading on creditors. This factor can be a huge obstacle for Thailand to prevent insolvent trading.

Even though creditors can claim damages via contractual rights, it is difficult to hold directors personally liable because when the company is in a state of insolvency, there is no specific duty imposed on directors to manage the corporation in a different way.

Time is of the essence for directors when considering whether a company is insolvent. If the corporation has financial difficulties, directors should operate the company with a high level of care to protect creditors' interests. On the other hand, creditors should have legal measures to protect their interests. Chapter 5 will further discuss the directors' duty when a company is in an insolvent state.

F *Obstacles to Reorganisation*

Many countries have their laws concerning company reorganisation. Reorganisation is a plan or process which can keep a company business alive when it faces a financial problem or becomes insolvent. It is reported that 'Thailand has the newest bankruptcy law in Asia, with a new reorganisation law which was effective on April 10, 1998'.[271] The new Thai reorganisation model was derived from the US and the UK reorganisation models under Chapter 11 of the US *Title 11 of* the *United States Code* ('*US Bankruptcy Code*') and the *Insolvency Act 1986* respectively.[272] The purposes of reorganisation are to improve and enable a company experiencing financial distress to overcome the failure of directors in managing the company and thus benefit

[271] Leslie A Burton, 'An Overview of Insolvency Proceedings in Asia' (2010) 6(1) *Annual Survey of International & Comparative Law*, 124.

[272] Wisit Wisitsora-at, *Thai Bankruptcy Law: Past, Present and Future,* Asean Law Association <http://www.aseanlawassociation.org/docs/w6_thai.pdf>.

creditors.[273] In Thailand, a state agency, creditors and debtors may file an application to a court to instigate a reorganisation program.[274] Any of these parties may, under s 90/2,[275] file a petition for the reorganisation of the debtor's business before a bankruptcy action has been instituted against the debtor. This is apparently a good option for a company to avoid insolvency but the statistics on reorganisation cases in Thailand, as shown in Table 3.1, indicate that the number of reorganisation cases is quite low compared with the total amount of insolvency cases.

Table 3.1: Company insolvency cases compared with reorganisation cases in Thailand

Year	Insolvency cases	Reorganization cases
1999	416	25
2000	994	135
2001	1573	84
2002	1906	60
2003	3378	51
2004	5683	52
2005	8021	38
2006	13 244	52
2007	15 380	57
2008	16 770	54
2009	18 525	42
2010	14 256	53
2011	9408	34
2012	6312	38
2013	4264	24
2014	3746	35
2015	3107	25

(**Source**: The Central Bankruptcy Court)[276]

Obviously, even though there are benefits for both creditors and debtors to reorganise the company before it becomes insolvent, the option of company reorganisation

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[273] Thanida Chitnomrath, Robert Evans and Theo Christopher, 'Corporate Governance and Post-Bankruptcy Reorganisation Performance: Evidence from Thailand' (2011) 19(1) *Asian Review of Accounting*, 50.

[274] Wisitsora-at, above n 272.

[275] The *Bankruptcy Act 1940* s 90/2 specifies:

> 'The creditor, the debtor or a State agency under s 90/4 may file a petition for the reorganization of the debtor's business in accordance with the provisions of this Chapter, regardless of whether a bankruptcy action has been instituted against the debtor or not.
>
> In respect of any part of the proceedings not specifically provided in this Chapter, the provisions in other Chapters of this Act shall apply mutatis mutandis.'

[276] The Central Bankruptcy Court, *Statistics of Case Law*, above n 4.

apparently is not popular with either creditors or debtors. There may be four explanations for this lack of popularity.

First, there is a problem of definition. According to s 90/2 of the *Bankruptcy Act*, the law allows the creditor, the debtor or a state agency to file a petition for reorganisation. The meaning of a 'debtor' is provided in s 90/1.[277]

However, there is currently no enforced Ministerial Regulation for reorganisation. Therefore, 'debtor', under s 90/2 only refers to a debtor of a limited company and a public company and does not include debtors of limited partnerships and registered ordinary partnerships.[278]

Second, ss 90/3[279] and 90/4[280] state that if a company becomes insolvent and has debts less than THB10 000 000, a company or creditors cannot file a petition for reorganisation of the company.[281] In this case, creditors can only wait for the company to become insolvent without themselves having any protection. In the present author's view, to allow corporations to undertake reorganisation without specifying a minimum debt threshold before it can do so may be an option for increasing creditors' protection in the Thai business sector.

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[277] The *Bankruptcy Act 1940* s 90/1 provides: 'Debtor means the debtor that is a limited company, a public limited company or any other juristic person as prescribed in the Ministerial Regulation.'

[278] Nitath Wangvivathana, 'Problems and Effects from the Reorganization Petition by Trial Courts' (Judicial Training Institute, The Court of Justice, 2013) 13.

[279] The *Bankruptcy Act 1940* s 90/3 states: 'When the debtor becomes insolvent and is indebted to one creditor or several creditors altogether in a definite amount of not less than ten million Baht, if there arises, whether such debt is due immediately or at a future time, a reasonable cause and prospect for the reorganisation of the debtor's business, the person under s 90/4 may file a petition with the Court for the business reorganisation.'

[280] The *Bankruptcy Act 1940* s 90/4 provides:

'Subject to s 90/5, the following persons are entitled to file a petition with the Court for the business reorganisation:

(1) one creditor or several credits altogether, with a definite amount of debt of not less than ten million Baht;

(2) the debtor of the description under s 90/3'.

[281] It is noted that a director can avoid the state of being insolvent. If a director evaluates the financial status of the company and finds that reorganization could not be helpful, he may take an option to avoid insolvent trading by making a decision to go out of business.

Third, in severe cases when creditors risk being unable to obtain remedies, some secured creditors may opt for enforcing their security interests over the company's assets instead of waiting for the corporate reorganisation to be complete. This is an obstacle to company reorganisation[282] because the creditors will try to expropriate the assets of the debtor company that are subject to mortgages, changes or other security interests, leading to an eventually unsuccessful reorganisation.[283] In other words creditors may be unwilling to support debtors because there is a chance, in the reorganisation, that creditors cannot make a legal claim for the payment of their debts.[284]

Fourth, it is possible that, in the Thai culture, reorganisation actually means insolvency, untrustworthiness and shame. Therefore, the company's owners or directors will avoid filing for reorganisation. Nevertheless, avoiding company reorganisation may not lead to satisfactory results either. The corporation may increase its debts, and put itself in an even more difficult financial situation and become even more indebted and, eventually, insolvent.

In sum, there are problems with encouraging Thai companies to reorganise. More encouragement to take up the reorganisation option may be a way for Thai corporate law to increase the level of protection for creditors. Moreover, it is a way to help debtors to return to a healthy financial situation.

III CONCLUSION

The insolvent trading problem has been a feature of the Thai business sector for many decades. Scholars and governmental agencies have been concerned about this issue, particularly during the 1997 Asian Financial Crisis.[285] UNCITRAL has pointed out

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[282] Wisit Wisitsora-at, 'Reorganisation' (1996) *Dullapaha B.E. 2539 (Office of Judicial and Legal Affair)* 49, 50.

[283] Legal Executive Department of the Finance Ministry, *Reorganisation in Bankruptcy Cases* <http://www.led.go.th/ff/articles.asp>.

[284] Ibid.

[285] See Lampros Vassiliou, *Global Forum on Insolvency Risk Management* World Bank < http://siteresources.worldbank.org/GILD/ConferenceMaterial/20158502/Vassiliou%20-%20Asian%20Recovery%20-%20FINAL.pdf.>, *Insolvency Reforms in Asia: An Assessment of the Implementation Process and the Role of Judiciary* OECD

that '[i]t is increasingly recognized that strong and effective insolvency regimes are important for all States as a means of preventing or limiting financial crises and facilitating rapid and orderly workouts from excessive indebtedness'[286]

However, as of March 2016, the problem of insolvent trading has not yet been dealt with. Thai corporate and insolvency laws still raise many problems. For example, a report by the Department of Foreign Affairs and Trade, Australia, highlights that Thailand still has inadequate protection for creditors, so that 'consequently, very few foreign banks currently are prepared to lend to Thai corporates, and local bank lending also is declining.'[287] Broude claims that one of the most significant problems of Thai corporate laws concerns reorganisation. The *Bankruptcy Act (1940)* provides for the reorganization procedure, but only for businesses with debts of more than THB10 000 000, and if 'there exist reasonable grounds and means to reorganize the debtor's business operations.'[288] In the matter of directors' duties, there are still gaps in the law, such as lack of clarity regarding the required standard of care, an absence of definitions for the different levels of directors, and the fact that a director's duty is expressed too broadly. In particular, there is no specific duty for directors when a company is in the insolvent state, when directors should actually increase their level of care in relation to operating the company.

Thailand has no particular provision to deal with the insolvent trading problem and thus insolvent trading continues to occur. It is relatively easy for directors in the Thai business context who operate a company dishonestly to defraud or misappropriate creditors' money or shareholders' properties. Even though there are sanctions to

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<https://www.oecd.org/daf/ca/corporategovernanceprinciples/1873992.pdf.> and Richard F Broude, *Business Insolvency in Thailand: Reform and Rehabilitation* OEDC <https://www.oecd.org/daf/ca/corporategovernanceprinciples/16211282.pdf>.

[286] See UNCITRAL, *UNCITRAL Legislative Guide on Insolvency Law: Relevance to International Trade* <http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html>.

[287] Department of Foreign Affairs and Trade, *Changing Corporate Asia: What Business Needs to Know,* Australian Goverment <http://dfat.gov.au/about-us/publications/trade-investment/changing-corporate-asia/Pages/changing-corporate-asia-what-business-needs-to-know.aspx>.

[288] Richard F Broude, 'Business Insolvency in Thailand: Reform and Rehabilitation' (OECD, 2005) 10 <http://siteresources.worldbank.org/GILD/Resources/Broude2.pdf>.

penalise directors in numerous ways, these sanctions are not adequate to overcome the problem.

Thai judges generally adopt a literal or a black letter law approach to the application of laws. Thus, because of the absence of a specific provision on insolvent trading in Thai corporate laws, Thai judges are inclined to hold that Thai company directors owe no duty to creditors to prevent insolvent trading as none have been expressed.

The consequence of the compounding inadequacies of the law and judgements to deal with insolvent trading discourages creditors, whether Thai or foreign investors, from investing in the Thai business sector, although, in fact, creditors' interests should be considered especially when a company is in financial distress. Mason J opines in *Walker v Wimborne* that a company director has to take into account the interests of creditors when the company becomes insolvent.[289] Therefore, 'the possibility of future insolvency is sufficient' to have an attention from a director to take creditors' interests into account.[290] Moreover, Drummond AJA in *Bell* also states that 'director(s), in discharging their fiduciary duties to their company must, if the company is sufficiently financially distress, have regard and give proper effect to the interests of creditors…'.[291] Consequently, the protection of creditors' interests from insolvent trading is a significant issue which the Thai government should be concerned.

Reforming Thai laws may be the best way to solve the problem of corporate insolvent trading and protect especially creditors' interests. The problem of insolvent trading, has not occurred only in Thailand. Developed countries, such as Australia, the UK, the US and Germany, have faced similar issues; but they have taken measures to resolve the insolvent trading problem. Studying the experiences of various countries may be useful to help improve and develop Thai laws to deal with insolvent trading. Another useful resource may be the *UNCITRAL Legislative Guide on Insolvency Law* for member states to stop such insolvent trading.

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[289] *Walker v Wimborne* (1976) 137 CLR 1, 7.

[290] Reginald Barrett, 'Directors' Duties to Creditors' (1977) 40(2) *The Modern Law Review* 226, 229.

[291] *Westpac Banking Corp v Bell Group Ltd* (in liq) (2012) 270 FLR 1, 36 [2031].

Using such resources, the next Chapter will examine possible provisions and a theory that Thailand may adopt to deal with insolvent trading.

CHAPTER 4: LESSONS FROM ABROAD CONCERNING CORPORATE INSOLVENT TRADING

I INTRODUCTION

As pointed out in the previous Chapters, current Thai laws do not have specific provisions for dealing with insolvent trading by company directors. In fact, the wording of Thai corporate law provides directors with loopholes to avoid personal liability for insolvent trading activities. Legal gaps are, for instance, created by a lack of a precise definition of 'director', uncertainty with respect to the standard of care required, and difficulties associated with lifting the corporate veil. However, the legal problem of insolvent trading is not confined to Thailand. Many countries, including the UK, Australia, the US and Germany, have faced this question. Unlike Thailand, however, these countries have made changes, in different ways, to their laws to deal with the problem. At a global level, the UNCITRAL also provides legislative guidelines for the making of insolvency laws to protect legitimate creditors' interests.

This chapter will initially review the development of the laws and the legislative guidelines dealing with corporate insolvent trading of the UK, Australia, the US, Germany and the UNICTRAL respectively and discuss the rationales for the introduction of such laws in these countries and the UNICTRAL guideline. Then, the chapter will discuss the specific provisions and legal doctrines in different countries and the guidelines suggested by UNCITRAL to prevent insolvent trading. The chapter will, in particular, suggest solutions to deal with insolvent trading problems in the Thai jurisdiction. More specifically, for the purpose of reforming Thai corporate and insolvency laws, the chapter will recommend a definition for a 'director', suggest that there be specific directors' duties to prevent insolvent trading, outline potential liabilities that directors might incur, discuss defences they may employ to avoid that liability and remedies that creditors may be able to claim if directors are found guilty of insolvent trading, as well as suggesting ways of encouraging organisations to reorganise.

II Background and Rationale to Prevent Insolvent Trading

The business sector continues to grow and diversify. To function effectively in an economy, the businesses sector needs regulation, not least to deal with insolvency problems. A company can quickly become insolvent because of any internal or external factors that may affect its financial structure; for example, the global economic crisis or illiquidity may lead a company to become insolvent. Creditors will, inevitably, be affected and suffer loss if a company or a debtor becomes insolvent. If a debtor's inability to pay is expected or is foreseeable, a creditor may have an opportunity to reduce his losses. It is not surprising, therefore, that legislatures in developing countries and the UNCITRAL attempt to set up rules to prevent companies from trading while they are unable to pay their debts.

In other words, the issue regarding which a company director should have personal liability to creditors has been considered. For example, Anderson claims that this issue has been debated by economists, social and legal theorists.[292] The theories relating directors' personal liability to creditors can be explained in many perspectives. For example, the theory is called agency cost and the nexus of contract theory. It is argued by Anderson that

> the contractarian views the company as a convenient fiction to aggregate inputs and to facilitate contracts," express and implied, between various parties - employees, suppliers, creditors and consumers. Shareholders are just one of these factors of production, and their contribution of equity capital is merely one type of input into the company[293]

In the view of the contractarians, reducing the cost of contracting can be efficient from the role of corporate law. One significant theoretical consideration is agency costs. It can explain that the principal under this theory is a company and a director is an agent.

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[292] Helen Anderson, 'Directors' Personal Liability to Creditors: Theory versus Tradition' (2003) 8 *Deakin Law Review* 209, 209.

[293] Ibid, 211.

Generally, the director has fiduciary duty to the principal.[294] However, sometimes the principal can be a company's creditors and a company is an agent. 'Creditors give rise to agency costs because there is a significant divergence of interest between the directors, who are under a duty to act in the best interests of the company, and the creditors.'[295]

> In times of doubtful solvency, when the interests of creditors ought to receive more attention than usual, agency theory suggests that directors' behaviour will deteriorate in terms of protecting creditors, in a last ditched attempt to preserve their principal, the company, and to save the funds of the shareholders. Yet from a shareholder's point of view, agency theory could also support an argument in favour of directors being personally liable to creditors in times of insolvency.[296]

However, a problem of this theory is the complexity of managing and understanding the interplay of agency costs. Anderson argued that the theory lacks usefulness in assisting courts to determine the issue of directors' personal liability to creditors.[297] Easterbrook and Fischel posit that

> To understand corporate law, you must understand how the balance of advantage among devices for controlling agency costs differs across firms and shifts from time to time. The role of corporate law at any instant is to establish rights among participants in the venture. Who governs? For whose benefit? But without answering difficult questions about the effectiveness of different devices for controlling agency costs, we cannot tell the appropriate allocation of rights.[298]

[294] Ibid, 212.
[295] Ibid, 213.
[296] Ibid.
[297] Ibid, 214.
[298] Frank H Easterbrook and Daniel R Fischel, 'The corporate contract' (1989) 89(7) *Columbia Law Review* 1416, 1428.

Bratton supports that even though the nexus of contracts theory has been well accepted, it has not been well understood.[299] Thus, it can be concluded that

> Agency theory and the company as a nexus of contracts, therefore, lack normative value and do not give a clear indication of the way in which the question of directors' personal liability to creditors ought to be settled. This is a major limitation on its adoption by the courts as a guiding principle to settle disputes between directors and creditors.[300]

Moreover, directors' personal liability to creditors can be viewed with other theories of law and economics such as trustee theory, managerial theory, shareholder primacy theory and director primacy theory. Furthermore, theories relating to creditor behaviour and creditor type and theories relating to director behaviour can also be examined for directors' personal liability.

What follows is a discussion of historical developments and rationales that triggered the UK, Australia, the US, Germany and the UNCITRAL to create laws to prevent insolvent trading in the business sector.

A *The United Kingdom*

The insolvent trading problem was first addressed in the UK in 1948. Under the *Company Act 1948* (UK), a company director was liable to creditors if he or she, with dishonest intent, carried on business while the company was unable to pay its debts.[301] This activity was called fraudulent trading. However, the fraudulent trading provision under the *Company Act 1948* was not efficient enough to protect creditors from losses incurred by insolvent trading. For example, in *Re Maidstone Building Provision*,[302] Pennycuick J held that the defendant was not personally liable for fraudulent trading, and 'emphasized the fact that the provision was a penal one.'[303] The court reasoned

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[299] William Bratton, 'The "Nexus of Contracts" Corporation: A Critical Appraisal' (1989) 74 *Cornell Law Review*, 410.
[300] Anderson, above n 292, 214.
[301] The *Company Act 1948* (UK) s 332.
[302] *Re Maidstone Building Provision Ltd* [1971] 1 WLR 1085.
[303] Andrew Keay, *Company Directors' Responsibilities to Creditors* (Routledge-Cavendish, 2007) 74.

that the defendant, as a partner who was appointed as a secretary of the firm, would not be liable for fraudulent trading simply for failing to advise the board of directors to stop trading when the firm had suffered a large loss. This reasoning shows that negligence in operating a company or engaging in irresponsible trading was inadequate to make directors liable in a fraudulent trading offence, particularly when there is an absence of fraudulent intention.

Such rulings raised concerns that unsecured creditors may not have enough protection under the *Company Act 1948*, including deriving compensation which should be available to a person who suffers from the 'unreasonable behaviour as well as fraudulent action'.[304] Consequently, a new provision called 'wrongful trading' was introduced.

The wrongful trading provision was suggested by the Review Committee in the 1982 inquiry into insolvency law and practice under Sir Kenneth Cork (*Cork Report*).[305] This report usefully provides a history of why the provision of 'wrongful trading' was introduced.

To begin with, prior to the *Insolvency Act 1986*, the fraudulent trading concept was introduced in s 332 of the *Company Act 1948*.[306] However, the Act had inadequacies in relation to the concept of fraudulent trading.[307] Section 332 referred to instances where companies were held to be trading dishonestly, for which both civil liability and criminal offences were available. Given that the elemental components were the same for both, the courts refused to approve the civil liability claim in the absence of dishonesty. In addition, a high standard of proof was required to prove a criminal offence.[308] While it was reasonable to expect that an offence was only proved if there was dishonest intention, it was thought to be inappropriate for the facts to be proved

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[304] Ibid.

[305] Sir Kenneth Cork, ' Insolvency Law and Practice' (The Report of Review Committee, Cmnd 8558,1982). ('*Cork Report*').

[306] Simon Plant and Michael Prior, 'Officers' and Directors' Liability in the Context of Insolvency' (2000) 28 *International Business Lawyer* 303, 306.

[307] Cork, above n 305, [1176].

[308] Ibid.

to the criminal standard in order to have access to a civil remedy. Hence, the *Cork Report* recommended that compensation could be awarded for both deceptive and unreasonable behaviour.[309] This is the first rationale for introducing the wrongful trading provisions as a result of the inadequacy of the coverage of fraudulent trading in s 332 of the *Company Act 1948*.

The *Cork Report* recommended that the whole of s 332 should be repealed and replaced with a new section providing a civil remedy.[310] Civil personal liability could arise '(a) without proof of fraud or dishonesty; and (b) without requiring the criminal standard of proof.'[311] Nevertheless, the phrase 'fraudulent trading' should be reserved for the kind of act which was an offence under s 332.[312] Recommendation (b), therefore, enabled claims to be made without claimants being burdened by the standard of proof.[313]

In addition, the *Cork Report* recommended that the new section create personal liability for a director due to their 'wrongful trading',[314] and that civil liability could be claimed. Thus it is submitted that the second rationale of the *Cork Report* is to create a provision that was much wider than that previously available.[315] Bruno argued that this new provision of wrongful trading would change the common law principle regarding the concept of duty of directors, 'not only stressing honesty and conscientiousness as requirements to avoid personal liability but also reasonable diligence and skill.'[316]

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[309] Ibid [1777].

[310] Ibid [1178].

[311] Ibid.

[312] Ibid [1179].

[313] See Justin Dabner, 'Insolvent Trading: An International Comparison' (1994) 7 *Corporate and Business Law Journal* 49, 57.

[314] Cork, above n 305, [1179].

[315] Ibid [1781]. The Committee argued: '[B]ut we intend the new civil liability for wrongful trading to be far wider than that. In the future, we propose that a company shall be trading wrongfully if, being insolvent or unable to pay its debts as they fall due, it incurs liabilities to other persons without a reasonable prospect of meeting them in full; and that a person who was party to the carrying on of the company's trading may be made personally liable for the debts of the company if he knew or, as an officer, ought to have known that the trading was wrongful.'

[316] Sabrina Bruno, 'Personal Liability of Corporate Directors Under English Common Law and Italian Civil Law' (1996) 2 *UC Davis Journal of International Law and Policy* 37, 77.

As regards fraudulent trading, the Review Committee highlighted another deficiency in s 332 since directors could avoid their personal liability for conducting a company while insolvent if they could show that they 'honestly believed that "there was light at the end of the tunnel and that the dark clouds had a silver lining".'[317] This is a subjective test.[318] The *Cork Report* recommended the use of an objective test for wrongful trading so that a director would be liable for trading in the absence of a reasonable prospect for the company to meet its obligations. Furthermore, the standard to be applied for the case of wrongful trading should be the reasonable person standard.[319] Effectively, this would change the test applied by the court from a subjective to an objective test.[320] Hence, it can be argued that another rationale for the inclusion of wrongful trading provisions concerns the modification of the tests which are applied to verify directors' management.

The *Cork Report* also recommended that the wrongful trading provisions should apply to all types of companies when they are unable to pay their debts as they fall due or when they are insolvent.[321]

The *Cork Report* also noted that '[t]rading when a business is heavily under-capitalised will often come within the concept of wrongful trading.'[322] This means that the main principle of wrongful trading is about making directors who are trading without a reasonable prospect of being able to repay debts liable for their actions.[323] Therefore, the last significant rationale of wrongful trading is to promote creditors' interests by imposing the duty on directors to prevent wrongful trading, particularly when the company is in significant financial distress.

317 Cork, above n 305, [1782].

318 Ibid.

319 Ibid [1783].

320 Ibid [1782-1783].

321 Ibid [1784]; The Review Committee argued that '[t]he essence of wrongful trading is the incurring of liabilities with no reasonable prospect of meeting them; whether by incurring debts with no reasonable prospect of paying them, or by taking payment in advance for goods to be supplied with no reasonable prospect of being to supply them or return the money in default.'

322 Ibid, [1785].

323 Ibid.

Furthermore, the *Cork Report* recommended that when a company is considered to be insolvent, directors should have a duty to put the company into receivership, administration or liquidation. Failing to do so should lead to civil liability for directors.[324] The significant change to the legislation was the creation of a director's duty to avoid wrongful trading when the company is in significant financial distress. Directors must be diligent in the management of their company. If their company becomes insolvent, directors must take urgent action to put the company on a path to liquidation, administration or receivership.[325] Failure to do so may lead to directors being held personally liable in a civil action.[326] The wrongful trading concept has been introduced to ensure that directors can be held liable if they do not take steps to minimise the potential loss of the company when 'an insolvent liquidation is a prospect'.[327] It can be concluded that directors, in relation to wrongful trading, will have an added duty in managing their companies, especially in a period where their business is extremely under-capitalised.[328]

As a result of the recommendations embedded in the *Cork Report*, a wrongful trading provision was enacted as s 214 of the *Insolvency Act 1986*. Bersheda notes that the wrongful trading provision in s 214 has effectively restructured directors' conduct when an enterprise falls into a difficult financial situation and is not only a means for creditors to obtain a remedy.[329] Ellington and Fletcher claim that, unlike fraudulent trading, 'wrongful trading catches not only the criminal and reckless, but the careless and incompetent'.[330]

Even though the wrongful trading provision is proposed to protect creditors' and other stakeholders' interests, there are disadvantages. For example, this provision can

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[324] Ibid, [1786].

[325] Ibid.

[326] Ibid, [1785-1786].

[327] Plant and Prior, above n 306, 307.

[328] See Maria Elena Perici Calascione, *Fraudulent and Wrongful Trading-Case Study of a Judicial Appreciation* (LLM Thesis, University of Van Tilburg, 2012), 10.

[329] Tetyana Bersheda, 'Insolvency Act 1986, Section 214: a Model for the European Initiative on Wrongful Trading' (2005) 1 *Cambridge Student Law Review* 63, 70.

[330] Paul R Ellington and Ian M Fletcher, 'Responsibility and Liabilities of Directors and Officers of Insolvent Corporations in the UK' (1988) 16(11) *International Business Lawyer* 491, 493.

discourage a qualified person from becoming a director; and wrongful trading liabilities can deter capable people from accepting a nomination to be a company director.[331] Similarly, Oesterle asserts that this section means 'the executives are less likely to take up positions on boards.'[332] In other words, directors must take a high risk in conducting a company when it is in financial distress.[333] Mannolini asserts that directors are unfairly penalised by this provision because some failures are possible through 'errors of judgement which they make',[334] and that creditors should protect themselves by having insurance, a contract or even a personal guarantee from directors.[335]

B *Australia*

As with most countries around the world, Australia also experienced the problems brought about by insolvent trading. The Australian Commonwealth Government attempted to resolve the problem by enacting insolvent trading provisions for the imposition of a positive duty on directors to prevent insolvent trading when the company is unable to pay its debts.[336] In particular, s 588G of the *Corporation Act 2001* (Cth)[337] provides certain protections for creditors' interests, particularly when a company is approaching insolvency. If a director fails to protect the company from insolvent trading, a number of sanctions may be applied against the director.[338]

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331 Keay (2005), above n 44, 435.

332 Oesterle, above n 40, 29.

333 Keay (2005), above n 44, 438.

334 Ibid.

335 Ibid.

336 The *Corporation Act 2001* (Cth) ss 588G-588Y.

337 The *Corporation Act 2001* (Cth) s 588G provides:

(1) This s applies if:

(a) a person is a director of a company at the time when the company incurs a debt; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and

(d) that time is at or after the commencement of this Act.

338 For example, ss 588J, 588M (2)(3), 588G(3).

The duty to prevent insolvent trading, however, took several decades to develop.[339] The historical development of Australian insolvent trading law can be found in the *General Insolvency Inquiry Report 1988 (The Harmer Report)*.[340] The following is a brief summary of that development:

In 1926, the Greene Committee,[341] which reviewed the circumstances where directors operated companies with an intention to defraud, proposed that directors should not have limited liability when a company is winding up, especially in relation to the debt of the company and liabilities for criminal fault.[342] Therefore a new provision should impose directors' liabilities for the debts without limitation in the winding up of a company and also impose a criminal offence for company directors. Such a provision was expressed in the *Company Act 1929* (UK).[343] Queensland was the first state to adopt a similar fraudulent trading provision in 1931, and then it was subsequently adopted by other States.[344]

In 1961, a new criminal offence was introduced by the *Uniform Companies Act (1961)*. Some legal scholars claim that this was the first step in making directors liable for trading while the company was insolvent as distinct from trading fraudulently.[345] Section 303 (3) of the *Uniform Companies Act (1961)* stated that if in the course of winding up, a company director took a part in incurring a debt without a reasonable expectation or probable grounds that the debt could be paid, the penalty was imprisonment for three months or a fine of AU$100.

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[339] Kathryn Neilson, *Weathering The Storm: Reforming Australia's Corporate Insolvency Laws for the Global Financial Crisis* (BA/LLB Thesis, The Australian National University, 2009) 7.

[340] The Law Reform Commission, 'General Insolvency Inquiry ' (ALRC Report no 45, 1988) (' Harmer Report')

[341] Company Law Amendment Committee, 'Report of Company Law Amendment Committee' (Cmd 2697, 1926) ('*Report of the Greene Committee*').

[342] Ibid [62].

[343] The *Company Act 1929* (UK) s 275.

[344] Niall F Coburn, 'Insolvent Trading in Australia: The Legal Principles' in Ian M Ramsay (ed), *Company Directors' Liability for Insolvent Trading* (The Centre for Corporate Law and Securities Regulation and CCH Australia Limited, 2000) 73.

[345] Ibid 74.

It can, therefore, be said that an important rationale for a provision of insolvent trading relies on the concept of directors' personal liability for fraudulent conduct. Companies are generally recognised as separate legal entities and directors are necessary agents to conduct companies' affairs. Directors are entitled to assume that they would not have personal liability for any transactions because they conduct the company's business as an agent of the company. However, there has been an attempt to create personal liability for directors in the case of fraudulent conduct or acting 'without due regard to the ability of the company to pay its debts.'[346] Moreover, from a historical development of company law, there is a need for directors to be aware of their responsibility when incurring debts. Directors could be held liable with civil and criminal liability for conduct detrimental to the company.[347]

In 1962, the UK *Jenkins Report*,[348] recommended that directors and others who operate a company in a reckless manner should be personally liable without limitation for all or any of the debts of the company. However, it was noted that there was opposition to imposing criminal punishment on that type of conduct.[349]

Civil liability for insolvent trading was introduced in 1964 in New South Wales for the first time. This new civil liability and declaration made a director personally liable for any debts if the debts were incurred without reasonable expectation of payment.[350] Nonetheless, a civil penalty was to be applied only in a case where the verdict was related to a criminal offence:[351] if there was no criminal offence, a court could not penalise a defendant with the civil sanction.

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[346] *Harmer Report*, above n 340, [272].
[347] Ibid [276].
[348] In the beginning, Australia adopted the UK law as a model.
[349] *Harmer Report*, above n 340, [278].
[350] The *Companies (Amendment) Act 1964* (NSW) s 304 (1A) states: '[w]here a person has been convicted of an offence under subs (3) of s three hundred and three in relation to the contracting of such a debt as is referred to in that subs the Court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare without any limitation of liability for the payment of the whole or any part of that debt.'
[351] *Harmer Report*, above n 340, [278].

In 1971, the question concerning civil liability was made clear. Sections 347C and 374D of the *Companies (Amendment) Act 1971* were incorporated into the company law of New South Wales. These amendments made it obvious that if a director incurs a debt without reasonable prospect of disbursement, there will be unlimited personal liability for that director.[352] The *Harmer Report* recommended that any debts incurred by non-reasonable expectations of payment should be paid by that director to the company and to all creditors.[353]

In 1981, there was a change regarding the nature of civil liability, which can be seen in s 556 of the former *Companies Act 1981* (Cth).[354] Yet the *Harmer Report* also states that 'at no stage since its introduction in 1961 has the liability of a director for incurring debts without a reasonable prospect of payment been in a form appropriate for giving creditors … a suitable remedy.'[355]

Moreover, the report also criticised the deficiencies of the directors' liability provision.[356] There were four main problems with the legislation:[357] (1) '[t]he liability contained in the 1961 uniform legislation was criminal only,'[358] (2) it was too hard for creditors to prove a claim reliant on a criminal standard of proof or upon a prior conviction for the offence, according to civil liability as introduced in 1964, (3) the lengthy procedure was a problem for protection of creditors' rights, and (4) there was confusion about the curious mixture of civil and criminal sanctions.[359] So, a second rationale for dealing with the problem of insolvent trading arises from deficiencies of director liability provisions since 1961.[360]

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352 Coburn, above n 344, 75.
353 *Harmer Report*, above n 340, [278].
354 Ryan Purslowe, 'Decisions in the Twilight Zone of Insolvency: Should Directors be Afforded a New Safe Harbour' (2011) 13 *The University of Notre Dame Australia Law Review* 113, 116.
355 *Harmer Report*, above n 340, [279].
356 Ibid.
357 Ibid.
358 Ibid.
359 Ibid.
360 Ibid.

Therefore, the law needed to be reformed, particularly in regard to the issue that insolvent trading had not been 'expressed as a positive duty owed to the company'.[361] The *Report* was attempting to promote the *pari passu* principle that all creditors should share in any sum recovered. The responsibility of directors also must be expressed in a positive form in order to prevent insolvent trading by incurring a debt without an expectation that it will be paid back.[362] In other words, for efficient protection, it is necessary to stop permitting the director as an agent of the company to trade after the company is unable to pay all its debts.

Subsequently, the *Corporate Law Reform Act 1992* (Cth) regulated the insolvent trading problem in ss 592 and 593 of the corporations law. It came into effect on 23 June 1993.[363] In 2001, the corporation law was replaced by 11 provisions.[364] The long-term developments of insolvent trading provisions are now incorporated in the *Corporations Act 2001* (Cth). This Act provides specific measures to deal with the problem of insolvent trading in s 588G to 588Z. It is noteworthy that s 588G applies to directors only.[365] The reason is that the *Harmer Report* focused on 'preventing the company from engaging in a course of insolvent trading rather than the incurring of the particular debt.'[366] Thus, the director, as the person who is controlling overall management of a company should bear liabilities incurred as a result of insolvent trading.[367]

Other rationales of insolvent trading have been described by several legal scholars. For example, Ramsay argued that the rationale for s 588G concerns inadequate contractual protection. He claims that, generally, a conflict of interest between shareholders and

[361] Ibid [280].

[362] Ibid.

[363] Farid Assaf, *Statutory Demands and Winding Up in Insolvency* (Lexis Nexis Butterworths, 2nd ed, 2012), 27.

[364] Karen O'Flynn, *The Harmer Amendments: 15 Years On,* Clayton UTZ <http://www.claytonutz.com.au/docs/UNSW_insolvency_paper.pdf>.

[365] The Parliament of the Commonwealth of Australia House of Representatives, 'Explanatory Memorandum Corporate Law Reform Bill 1992' 1992 [1089].

[366] Ibid.

[367] Ibid.

creditors may arise from many sources. One main source is excessive risk-taking. When a company engages in high-risk investment, and if the project is successful, the excess is returned to shareholders as dividends, but is not to be shared with creditors. On the other hand, creditors and shareholders have to share when the company has losses. This does not seem to be fair to creditors.[368]

Creditors generally expect that their interests will be afforded proper contractual protection. For instance, first, 'the interest rate on the loan that is negotiated between the creditor and the company can be expected to reflect the risks that a creditor faces'.[369] Second, the company may be restricted from pursuing some activities by a contract. For example, a company may be prohibited from incurring debts of a similar or higher priority.[370]

In addition, Purslowe claims that the rationale behind the insolvent trading provision is about creditors' protection.[371] The clearest expressed judgment perhaps is that of Street CJ in *Kinsela v Russell Kinsela Pty Ltd*.[372] The Court stated that

> In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise … But where a company is insolvent the interests of creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency or the imposition of some alternative administration.

[368] Ian M Ramsay, 'An Overview of the Insolvent Trading Debate' in Ian M Ramsay (ed), *Company Directors' Liability for Insolvent Trading* (The Centre for Corporate Law and Securities Regulation and CCH Australia Limited, 2000) 9-13.
[369] Ibid 10.
[370] Ibid
[371] Purslowe, above n 354, 119.
[372] *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, 730.

Ryan notes that, even though this case deals with the insolvent trading provision prior to s 588G, the same rationale for creditor protection applies.[373] Following the reasons outlined, Ramsay concluded that excessive risk-taking by shareholders is a significant problem which confronts creditors. 'Shareholders now have an even more powerful incentive to engage in risky investment.'[374] For that reason, s 588G was introduced for resolving the contractual problem and protecting the creditors' interests.

Harris stated that the liability imposed in s 588G is a statutory exception to the principle that 'corporate debts are owed by the company as a separate legal entity and not by the owners of the company who enjoy limited liability.'[375] It can be said that creditors have quite a lot of protection because of fiduciary and common law duties, such as duty of care, duty to avoid a conflict of interest and duty to act in good faith, which directors have to meet for managing a company, as well as statutory duties imposed, especially for trading whilst the company is insolvent. Harris' argument is directly related to the *Harmer Report*'s concept, which aimed to protect creditors' interests and focus more awareness on directors operating insolvent companies. Furthermore, in the *Woodgate* case,[376] Barrett J also referred to the rationale of insolvent trading as one which protects the welfare of creditors and society from the potential mismanagement of directors.[377]

Section 588G has significant influence on the Australian business sector. James, Ramsay and Siva note that awards against directors for insolvent trading differ considerably, with the highest award being $96.7 million and the lowest $517. The average compensation amount ordered by courts is $1.7 million.[378] The figures indicate

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[373] Purslowe, above n 354, 119.
[374] Ramsay, above n 368, 13.
[375] Jason Harris, 'Director Liability for Insolvent Trading: is the Cure Worse than the Disease?' (2009) 23(3) *Australian Journal of Corporate Law* 1, 2.
[376] *Woodgate v Davis* (2002) 55 NSWLR 222 ('*Woodgate Case*').
[377] Ibid, 36.
[378] Paul James, Ian Ramsay and Polat Siva, 'Insolvent Trading-an Empirical Study' (72, The University of Melbourne: Faculty of Law, 2004), 2.

that insolvent trading regulations have become a significant provision affecting the Australian economy.

Parbery argued at the Corporations Law Nation-Wide Seminar held in 2008 that there are a number of positive grounds for imposing personal liability on directors for engaging in insolvent trading:

1. It encourages directors to be aware of their company's finances.

2 It may encourage directors to relinquish control and allow creditors to determine the company's future.

3. It may allow creditors to improve their position by suing directors for recovery although, from the few cases of this type, there is little evidence of that benefit. However, the threat of action is often used to negotiate a better deal for creditors when negotiating deeds of company arrangements.[379]

Oesterle, however, argues that, like the wrongful trading provisions in the UK, the insolvent trading provisions under the Australian law define an overly strict regime.[380] The provision may deter a qualified person from becoming a director of a company.[381] Moreover, there is no certain evidence showing that insolvent trading provisions are 'an economic necessary' which can protect market failure.[382]

C *The United States*

Unlike other common law countries such as Australia and the UK, the US does not have specific statutes to deal with insolvent trading or the wrongful trading problem.

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[379] Stephen Parbery, 'Current Issues and Developments in Corporate Insolvency Law and Practice' (Paper presented at the Corporations Law Nation-Wide Seminar, Federal Court of Australia, 2 April 2008) <http://www.nswbar.asn.au/circulars/corporations.pdf>.

[380] Dale A Oesterle, 'Corporate Directors' Personal Liability for "Insolvent Trading" in Australia, "Reckless Trading" in New Zealand And "Wrong Trading" in England: a Recipe for Timid Directors, Hamstrung Controlling Shareholders and Skittish Lenders' in Ian M Ramsay (ed), *Company Directors' Liability for Insolvent Trading* (The Centre for Corporate Law and Securities Regulation and CCH Australia Limited 2000), 20.

[381] Ramsay, above n 368, 9.

[382] David Morrison, 'The economic necessity for the Australian insolvent trading prohibition' (2003) 12(3) *International Insolvency Review* 171, 178.

Oesterle points out that in the US, if creditors would like to have an insolvent trading protection, it can provide expressly to them in 'the credit contract'.[383] Moreover, directors can be liable from insolvent trading under a tortious concept instead.[384] Thus, to control the insolvent trading problem, a number of jurisdictions in the US have adopted two interesting measures: a theory, called deepening insolvency, and fiduciary duty. However, neither measure has been applied consistently in individual States; for example Pennsylvania, Tennessee and Michigan, have recognized deepening insolvency as a cause for action, whereas Texas, Illinois and Colorado, claim that deepening insolvency is a theory of damages.[385] Furthermore, some courts, such as the courts in New York and Delaware, have refused to apply 'deepening insolvency claims as if they were a form of a general breach of fiduciary duty claim.'[386] The Federal Courts have also applied the theory of deepening insolvency in various ways.

1. 'Deeping insolvency'

First, it is necessary to explain the theory of 'deepening insolvency'. Konstantinov argues that deepening insolvency was initially based on tort law.[387] When a company comes within the zone of insolvency[388] or becomes insolvent, a director may prolong the company's life with fraudulent intention and consequently incur a corporation's

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[383] Oesterle, above n 380, 22.

[384] Dmitry Konstantinov, 'Wrongful Trading: Comparative Approach (England and Wales, Russia and the USA)' (2015) 2(1) *BRICS Law Journal* 100, 101.

[385] Ronald R Sussman and Benjamin H Kleine, 'What is Deepening Insolvency?' (2006) 15(6) *The Journal of Bankruptcy Law and Practice* 793, 794-795.

[386] David C Thompson, 'A Critique of "Deepening Insolvency," a New Bankruptcy Tort Theory' (2007) 12(2) *Stanford Journal of Law, Business and Finance* 536, 539.

[387] Konstantinov, above n 384, 106.

[388] Anna Manasco Dionne, 'Living on the Edge: Fiduciary Duties, Business Judgment and Expensive Uncertainty in the Zone of Insolvency' (2007) 13 *Stanford Journal of Law, Business & Finance* 188, 188. Dionne explains that ' [t]he terms "brink," "vicinity," and "zone" of insolvency are equivalent. They refer to some period of time when solvent firms are barely so, or very near to insolvency.' In other words, a company which is in the zone of insolvency means a company is nearing or approaching insolvency but it is not insolvent yet. Therefore the meaning of 'insolvent state' and 'zone of insolvency' are different. When a company is in the insolvent state, it means that a company is already insolvent whether having a court's order to be an insolvent company. However, if acompany is in the zone of insolvency, it means that a company is nearing or approaching insolvent but it is not insolvent yet.

debts or dissipate the company's assets.[389] Directors and officers have a liability to creditors because they have an obligation to protect creditors' interests according to the theory of deepening insolvency.[390] Nevertheless, the concept of deepening insolvency is not obviously defined or explained;[391] as the 9th Circuit Court in *Smith v Arthur Andersen LLP*[392] stated: 'it is difficult to grasp exactly what the theory entails.'[393]

Rubin claims that, with respect to deepening insolvency, there is confusion about whether the theory should be expressed as a theory of damages or an independent cause of action.[394] Unsurprisingly, the American courts still have different views about the concept of deepening insolvency.[395] Noteworthy is that this theory is not created or recognized in the *Bankruptcy Code* or in other federal laws:[396] deepening insolvency is applied as a State law. Consequently, some courts may refer to deepening insolvency as an independent cause of action,[397] and other courts claim that it is a theory of damages.

With regard to the historical development of deepening insolvency, it is widely accepted that the theory was created by cases in the 1980s, in which directors breached their fiduciary duty by fraudulently prolonging the corporation's life.[398] In many cases, the in *pari delicto* (equal fault) principle was referred to as a defence for directors to

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[389] TaeRa K Franklin, 'Deepening Insolvency: What It Is and Why It Should Prevail' (2005) 2 *NYU Journal of Land Business* 435, 437.

[390] Douglas R Richmond, Rebecca Lamberth and Ambreen Delawalla, 'Lawyer Liability and the Vortex of Deepening Insolvency' (2006) 51 *Saint Louis University Law Journal* 127, 127.

[391] Paul Rubin, 'New Liability Under "Deepening Insolvency"' *American Bankruptcy Institute Journal* <http://www.herrick.com/sitefiles/publications/805d53435768ce5436a02ff829d497c8.pdf>.

[392] *Smith v Arthur Andersen* LLP 421 F 3d 989 (9th Cir 2005).

[393] Ibid 19.

[394] Rubin, above n 391.

[395] William A Brandt Jr and Vance E Catherine, 'Deepening Insolvency and the United Kingdom's Wrongful Trading Statute: A Comparative Discussion' (2006) 19(10) *Insolvency Intelligence* 156, 156.

[396] See *Official Comm. of Unsecured Creditors of Vartec Telecom, Inc. v Rural Tel. Fin. Coop* (In re Vartec Telecom, Inc) 335 BR 631, [638]

[397] Michael Schillig, 'Deepening Insolvency: Liability for Wrongful Trading in the United States?' (2009) 30(10) *Company Lawyer* 298, 299.

[398] Eric Kim, 'Still Solvent: The Third Circuit Continues to Support "Deepening Insolvency" As a Viable Tort Claim in In Re Lemington Home for The Aged' (2012) 57(4) *Villanova Law Review* 739, 744.

deny their liability of prolonging a corporation's life.[399] The first case which used the deepening insolvency theory is *Bloor v Dansker*.[400] In this case, the plaintiff, the corporation's bankruptcy trustee, alleged that the defendant looted the corporation, artificially prolonged the corporation's life and created new capital to steal.[401] The defendant argued that under the in *pari delicto* doctrine, the plaintiff's standing in the shoes of the corporation could not recover for 'wrongdoing for which the corporation itself was responsible.'[402] The court decided that '[a] corporation is not a biological entity for which it can be presumed that any act which extends its existence is beneficial to it.'[403] The court did not rule in favour of the directors. The primary reason was that the insiders' artificial prolongation of the debtor's solvency benefited only them and 'their confederates and not the corporation, which continued to deteriorate financially as their scheme went on.'[404] With the dicta of the court's sentence in this case, the first step towards the concept of deepening insolvency was created.[405]

Since then, the deepening insolvency theory has been applied in many cases. However, as already noted, the theory has not been recognised by all courts.[406] Nevertheless, the courts of some States do recognize this theory. There are two ways to apply the

[399] Ibid, 745.

[400] *Bloor v Dansker* (In re Investors Funding Corp of New York Securities Litigation), 523 F. Supp.533 (SDNY, 1980) According to the theory of deepening insolvency, the plaintiff can hold a different status such as trustee, liquidator or creditors as mentioned in cases. However, one significant point is that under this theory, creditors, even named in another status, will be protected from unreasonable trading called deepening insolvency.

[401] Ibid, 541.

[402] Thompson, above n 386, 538.

[403] *Bloor v Dansker* (In re Investors Funding Corp. of New York Securities Litigation), 523 F. Supp 533 (SDNY, 1980), 541.

[404] Richmond, Lamberth and Delawalla, above n 390, 130.

[405] Thompson, above n 386, 538.

[406] Richmond, Lamberth and Delawalla, above n 390, 131. See also *Alberts v Tuft* (*In re Greater SE Cmty Hosp Corp*), 333 BR, 506 (Bankr DDC 2005), 517 (rejecting deepening insolvency theory as duplicative of other claims); *Bondi v Bank of Am Corp* (*In re Parmalat*), 383 F Supp 2d 587 (SDNY 2005), 601-02 (declining to recognise deepening insolvency as a cause of action under North Carolina law).

allegations of deepening insolvency. It can be applied as a theory of damages[407] or as an independent cause of action.[408]

In regard to applying it as a theory of damages, deepening insolvency was recognized in 1983 by the 7th Circuit court in *Schacht v Brown*.[409] The plaintiff was an insurance director, acting as a liquidator of Reserve Insurance Company, who alleged that, as a result of the defendants' fraudulent schemes, the company was far from the point of insolvency. The defendants still continued doing business, which resulted in excessive loss to Reserve Insurance Company, exceeding US$100 million.[410] The defendants claimed that 'a corporation may never sue to recover damages alleged to have resulted from the artificial prolongation of an insolvent corporation's life.'[411] However, the 7th Circuit Court reasoned:

> the fraudulent prolongation of a corporation's life beyond insolvency is automatically to be considered a benefit to the corporation's interests … for the corporate body is ineluctably damaged by the deepening of its insolvency, through increased exposure to creditor liability.[412]

Gordon claims that the court affirmed 'deepening insolvency as the applicable theory of damages.'[413] This decision has been followed in several other cases.[414]

With regard to an independent cause of action, the *Official Comm of Unsecured Creditors v R F Lafferty & Co* (the '*Lafferty case*')[415] ruled on by the 3rd Circuit Court is the first acknowledged case establishing that a deepening insolvency allegation is

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[407] See also *Drabkin v L & L Constr Assocs* (*In re Latin Inv Corp*), 168 BR I (Bankr D DC 1993); *Hannover Corp of Am v Beckner*, 211 BR.849 (MD La 1997); *Allard v Arthur Andersen & Co*, 924 F Supp 488 (SDNY 1996).

[408] See also *Devon Mobile Commc'ns v Adelphia Commc'ns Corp* (*In re Adelphia Commc'ns Corp*), 324 BR 492 (Bankr SDNY 2005); *In re Exide, 299 BR 732, (Bankr 2003)*; *Official Comm of Unsecured Creditors v RF Lafferty & Co*, 267 F 3d340 (3rd Cir, 2001) ('*Lafferty case*').

[409] *Schacht v. Brown*, 711 F.2d 1343 (7th Cir. 1983).

[410] Ibid 1345.

[411] Ibid 1350.

[412] Ibid.

[413] David E Gordon, 'The Expansion of Deepening Insolvency Standing: Beyond Trustees and Creditors' Committees' (2005) 22 *Emory Bankruptcy Developments Journal* 221, 223.

[414] Richmond, Lamberth and Delawalla, above n 390, 133.

[415] *Lafferty case* 267 F.3d340 (3rd Cir, 2001).

an independent cause of action in tort.[416] The Official Committee of Unsecured Creditors, being a plaintiff, alleged, regarding the defendants, that there were damages to the company's assets from the fraudulent expansion of the company's debts and the prolongation of the company's life. In other words, the defendant wrongfully increased debts without the capacity to repay.[417] The 3rd Circuit court held that, under Pennsylvania law, the deepening insolvency theory would be recognised.[418] In addition, the court reasoned:

> First and foremost, the theory is essentially sound … Under federal bankruptcy law, insolvency is a financial condition in which a corporation's debts exceed the fair market value of its assets … Even when a corporation is insolvent, its corporate property may have value. The fraudulent and concealed incurrence of debt can damage that value in several ways. For example, to the extent that bankruptcy is not already a certainty, the incurrence of debt can force an insolvent corporation into bankruptcy, thus inflicting legal and administrative costs on the corporation.[419]

However, this court's decision provided no guidance on the matter of required elements and available damages for an independent cause of action.[420] In 2003, the court of Delaware in *In re Exide Technologies, Inc* ('*Exide case*')[421] recognised deepening insolvency as an independent cause of action in tort. Gordon claims that 'these decisions have paved the way for a growing judicial acceptance of deepening insolvency as an independent cause of action.'[422] After the court's decisions in the

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[416] Thompson, above n 386, 538.
[417] *Official Comm. of Unsecured Creditors v R.F. Lafferty & Co.*, 267 F.3d340 (3d Cir. 2001), 345.
[418] Ibid, 349.
[419] Ibid, 349-350.
[420] Thomas J Vollbrecht and Theresa A Gooley, 'Deepening Insolvency Claims: Can You Become More Bankrupt? Can You (or Someone Else) Sue If You Do?' (2007) 13 *fidelity Law Association Journal* , 176.
[421] *Official Comm. of Unsecured Creditors v Credit Suisse First Boston* (In re Exide Techs., Inc), 299 B.R. 732 (Bankr. D. Del. 2003).
[422] Gordon, above n 413, 225.

Lafferty case and the *Exide* case, plaintiffs had a new and powerful weapon with which to fight the fraudulent and concealed incurrence of debt by directors or officers.[423]

Even though the historical development of the deepening insolvency theory shows that deepening insolvency was recognised in the 1980s, the theory is not recognised in the *Bankruptcy Code* or in other federal laws; instead, it is recognised by some states and rejected by other states. An interesting case, which rejected the deepening insolvency theory, is found in the Southern District Court of New York in 2004. *In re Global Service Group LLC*,[424] the Global Service Group filed for bankruptcy. After that, the bankruptcy trustee sued Global's insiders (the Goldmans and Cohen) and Atlantic bank, who were defendants in this case. The trustee alleged that, at that time, the financial status of Global was insolvent or in the pre- insolvency period, that is, undercapitalised.[425] The trustee also alleged that Atlantic Bank knew or should have known about Global's situation. However, because of the strength of the relationship between Global's insiders and Atlantic Bank, the bank approved the loan to Global.[426] These facts seem to indicate that the bank allowed Global to 'prolong its corporate existence and incur increased debt'.[427] Consequently, the issue of deepening insolvency was raised as a trustee's cause of action to the court. The Southern District Court mentioned that the theory of deepening insolvency was treated differently. It has been treat as an independent cause of action in some States while other states viewed it as a theory of damages. Moreover, some States rejected the deepening insolvency theory.[428] Hence, it was not necessary to draw a distinction between States. However, the court held that:

> one seeking to recover for 'deepening insolvency' must show that the defendant prolonged the company's life in breach of a separate duty, or committed an

[423] Ibid, 227.
[424] *Kittay v Atlantic Bank of New York* 316 BR 451 (Bankr SDNY 2004).
[425] Ibid 455.
[426] Ibid.
[427] Ibid 455-456.
[428] Ibid 457-458.

actionable tort that contributed to the continued operation of a corporation and its increased debt.[429]

Moreover, the court pointed out that, in this case, the Atlantic Bank should be liable for Global's deepening insolvency because the bank knew or should have known that Global could not pay back the loan. The Court opined: '[T]his may be bad banking, but it isn't tort.'[430] There were no prohibitions, however, for lenders from extending credit to an insolvent entity: it was 'neither surprising nor improper.'[431] The bank preferred to approve the loan to those they knew and had the right to insist on personal guarantees and pledges. Noticeably, the trustee did not allege that the bank 'extended the loans to enable the Goldmans to siphon off the funds or commit some other wrong.'[432]

The court was of the opinion that a manager of the insolvent company had an absolute duty to liquidate the company, and 'anyone who knowingly extends credit to the insolvent company breaches an independent duty in the nature of aiding and abetting the managers' wrongdoing.'[433] However, in the court's view, this may not always be the right assumption.[434]

Finally, the court held that both directors and officers had a fiduciary duty to the company and its shareholders.[435] In addition, when the company became insolvent, the fiduciary duty of directors and officers could be extended to creditors. Directors and officers owe duties 'to multiple constituencies whose interests may diverge.'[436]

In 2006, the Delaware Chancery Court overruled the decision of the 2003 *In re Exide Technologies, Inc*. The court in *Trenwick*[437] held that Delaware does not recognise

[429] Ibid 458.
[430] Ibid 459.
[431] Ibid.
[432] Ibid.
[433] Ibid.
[434] Ibid.
[435] Ibid.
[436] Ibid, 460.
[437] *Trenwick Am Litig Trust v Ernst & Young LLP*, 906 A 2d 168 (Del Ch 2006) ('*Trenwick case*').

deepening insolvency as an independent cause of action. Moreover, the court claimed that a breach of fiduciary duty, fraud, fraudulent conveyance and breach of contract should be considered for the case rather than applying the deepening insolvency principle as a cause of action. The Delaware court reasoned that:

> Delaware law does not recognize this catchy term as a cause of action, because catchy though the term may be, it does not express a coherent concept. Even when a firm is insolvent, its directors may, in the appropriate exercise of their business judgment, take action that might, if it does not pan out, result in the firm being painted in a deeper hue of red. The fact that the residual claimants of the firm at that time are creditors does not mean that the directors cannot choose to continue the firm's operations in the hope that they can expand the inadequate pie such that the firm's creditors get a greater recovery. By doing so, the directors do not become a guarantor of success. Put simply, under Delaware law, 'deepening insolvency' is no more of a cause of action when a firm is insolvent than a cause of action for 'shallowing profitability' would be when a firm is solvent. Existing equitable causes of action for breach of fiduciary duty, and existing legal causes of action for fraud, fraudulent conveyance, and breach of contract are the appropriate means by which to challenge the actions of boards of insolvent corporations.[438]

Therefore, creditors cannot claim damages under the theory of deepening insolvency. The available claim for creditors under the Delaware law should be the claim occurring from the violation of fiduciary duty of directors. This shows that the Delaware courts have tended to apply a fiduciary duty to directors of the company in the pre-insolvency period. Therefore, the deepening insolvency theory was finally rejected by the court in Delaware as the decision in the *Trenwick case* reveals.

The 3rd Circuit Court's view of the deepening insolvency theory was influenced by the 7th Circuit judgement in *Schacht v Brown*.[439] However, the doctrine was applied as a cause of action. Referring to the leading *Lafferty case*[440] and the deepening insolvency

[438] Ibid, 174.
[439] *Schacht v Brown*, 711 F 2d 1343 (7th Cir 1983).
[440] *Lafferty case*, 267 F.3d340 (3d Cir. 2001).

principle applied in Pennsylvania, the United States Court of Appeals for the 3rd Circuit stated clearly that even the Pennsylvania Supreme Court had not determined that deepening insolvency is recognised as a cause of action, but the Court assumed that the Supreme Court would recognise, that in Pennsylvania the deepening insolvency may give rise to a cognisable injury to corporate debtors.[441] Consequently, the theory of deepening insolvency has been recognised and used under Pennsylvania State law.

Recently a decision by the 3rd Circuit Court in *Lemington*[442] clearly explained the duties of directors under the deepening insolvency theory. The 3rd Circuit Court held that even though deepening insolvency has not been formally recognised as a cause of action by the Pennsylvania Supreme Court, the court believed that the Supreme Court would decide that 'deepening insolvency may give rise to a cognisable injury.'[443] Moreover, the court also clarified that 'deepening insolvency in Pennsylvania is defined as an injury to [a debtor's] corporation property from fraudulent expansion of the corporate debt and prolongation of corporate life.'[444] The significant decision in *Lemington* concerning the theory of deepening insolvency is that the court concluded that the primary element of deepening insolvency to support a claim of deepening insolvency is fraud.[445] In addition, the court referred to the decision of a prior case[446] asserting that 'a claim of negligence cannot sustain a deepening-insolvency cause of action.'[447]

According to *Lemington*, deepening insolvency must have occurred by fraudulent intention only. If there is no such fraudulent act, a negligent act of itself is inadequate to be considered as the primary element of a deepening insolvency claim. This shows

[441] Ibid, 350. The Court claimed that 'deepening insolvency may give rise to a cognisable injury to corporate debtors. See, eg, ibid (Applying Illinois law and holding that, where a debtor corporation was fraudulently continued in business past the point of insolvency, the liquidator had standing to maintain a civil action under racketeering law).'

[442] *In Official Committee of Unsecured Creditors v Baldwin* (In re Lemington Home for the Aged), 659 F 3d 282, 290 (3rd Cir 2011) ('*Lemington*').

[443] Ibid, 293-294.

[444] Ibid 294.

[445] Ibid.

[446] *In re Citx Corporation, Inc*, 448F 3d 672, (3rd Cir, 2006).

[447] Ibid 681.

that deepening insolvency requires fraud for a complaint. In contrast, insolvent trading and wrongful trading under Australian and British laws respectively do not require a fraudulent act in order to establish the personal liabilities of company directors. If there is a reasonable prospect or reasonable ground to suspect that a firm will be insolvent, directors must avoid trading while the company is or becomes insolvent. If directors violate the duty to prevent insolvent trading or wrongful trading, they will be held personally liable. It seems likely that deepening insolvency pursuant to the decision of the Third Circuit Court in *Lemington* is quite similar to fraudulent trading under s 213 of the *Insolvency Act 1986* (UK), because fraud is one requirement of fraudulent trading while it is not needed for wrongful trading.

For the reasons given, the deepening insolvency theory will not be explained further since fraudulent trading or fraudulent prolongation of the corporation's life is not the main focus of this thesis. The main focus of the thesis is looking for the duty and personal liabilities of directors under the insolvent trading principle, which is different from fraudulent trading. The thesis attempts to ascertain duties and personal liabilities of directors who did not necessarily intend to commit fraud against the corporation but failed to prevent the company from incurring debts while it was insolvent.

2. 'Fiduciary Duty'

The fiduciary duty of directors has been applied differently by different States. The fiduciary duty as applied in Delaware State will be first considered, as suggested by Huebner and McCullough, because there is a large number of big companies in this State, and Delaware has a strong tradition of advanced development in this field when compared to other US States.[448] However, it is worthy to note that the Delaware courts

[448] Marshall Huebner and Hugh McCullough, *The Fiduciary Duties of Directors of Troubled US Companies: Emerging Clarity*, Davis Polk & Wardwell <http://www.dwt.com/files/Publication/83f3acc3-dd8a-4981-83ff-f4c320b64d7d/Presentation/PublicationAttachment/6491db06-2ffb-432c-919d-49100865618f/The%20Fiduciary%20Duties%20of%20Directors%20of%20Troubled%20U%20S%20%20Companies%20-%20Emerging%20Clarity.pdf>.

do not provide a specific framework for understanding the elements of a fiduciary duty as it relates to company directors.[449]

Under Delaware law, when a company is solvent, directors of a corporation owe a fiduciary duty to shareholders to run the company for the benefit of shareholders. Directors of a solvent company have no fiduciary duty to creditors, as ruled by the Supreme Court of Delaware in *Gheewalla*:[450]

> The directors of a corporation owe their fiduciary obligations to the corporation and its shareholders. While shareholders rely on directors acting as fiduciaries to protect their interests, creditors are afforded protection through contractual agreement, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, bankruptcy law, general commercial law and other sources of creditor rights … The general rule is that directors of a corporation do not owe creditors duties beyond the relevant contractual terms.[451]

This decision stated clearly that directors do not owe fiduciary duties to creditors while the company is solvent. There might be a question if the company is insolvent or becomes insolvent, whether the fiduciary duty of directors will be shifted from shareholders to creditors. The Delaware court reasoned:

> [T]he need for providing directors with definitive guidance compels us to hold that no direct claim for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency. When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their

[449] Katarzyna Chalaczkiewicz-Ladna, 'The Relevance of the Long-Term Interests in the Decision Making Processes of Company Directors in the UK, Delaware and Germany: "The end of history" for directors' fiduciary duties?' (Paper presented at the The Interaction of National Legal System: Convergence or Divergence?, Vilnius University, 2013) 73<https://jak.ppke.hu/uploads/articles/12417/file/Vilnius%20University.pdf#page=71>.

[450] *North American Catholic Educational Programming Foundation, Inc v Gheewalla* 930 A 2d 92, (Del 2007) ('*Gheewalla*').

[451] Ibid, 99.

> business judgment in the best interests of the corporation for the benefit of its shareholder owners.[452]

Thus, even if the company is in the zone of insolvency, directors still owe their main duty to shareholders and the corporation, not creditors. A similar ruling by the Delaware court was found in *Trenwick*. The court opined that:

> Even when the firm is insolvent, directors are free to pursue value-maximizing strategies, while recognizing that the firm's creditors have become its residual claimants and the advancement of their best interests has become the firm's principal objective.[453]

Therefore, it can be said that the essential task of company directors is the same even though the company is or becomes insolvent. While directors owe a fiduciary duty to the company and its shareholders, they owe no duty to creditors in Delaware.

These decisions highlight a number of issues. First, as mentioned, Delaware has finally rejected the principle of deepening insolvency as a cause of action, even though previous court decisions did accept the theory (in *In re Exide Technologies, Inc* in 2003). The Court's decision in *Gheewalla* and *Trenwick*, rejected the theory of deepening insolvency as a cause of action in Delaware. Therefore, creditors cannot claim damages under the theory of deepening insolvency. The available claim for creditors under the Delaware law should be the claim occurring from the violation of fiduciary duty of directors.

The second issue is whether the fiduciary duty provides any protection for creditors in the case of company insolvency or pre-insolvency. As discussed above, directors owe no positive duty to creditors, regardless of whether a company is solvent or insolvent. This means that there is no direct directors' liability to creditors. When the company is insolvent, stakeholders can bring a claim against a director on behalf of the company

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[452] Ibid, 101.

[453] *Trenwick*, 906 A.2d 168 (Del. Ch. 2006), 175.

only and for the benefit of the company.[454] In regard to creditors, the Delaware court did not allow creditors to bring fiduciary claims against directors;[455] creditors can sue directors only with the derivative claim on behalf of the corporation.[456] In *Trenwick*, the court pointed out that it is illogical to extend the right to litigation for creditors in order to sue directors because that right is generally denied when the company is solvent.[457]

It is obvious that, under the umbrella of fiduciary duty, creditors in Delaware who suffer from an insolvent company have not been provided with special measures, or with any extra rights flowing from directors' liabilities. Consequently, creditors were not provided with the right to sue directors directly. Thus this thesis will not study further the duties and liabilities of directors according to the fiduciary duty under Delaware law because the Delaware case does not conform to the aims of the research, which is to find out the special measures to deal with the problem of trading while the company is insolvent.

In regard to fiduciary duties of directors ruled on by the 3rd Circuit Court, the court in *Lemington* held that 'fiduciary duties are owed not only to the corporation and its shareholders, but also to the creditors of an insolvent entity.'[458] This decision is starkly different from those of the court of Delaware.[459]

Mostly, the consent of both parties creates fiduciary relationships, though some fiduciary duties may arise before or after the clear relationship of the parties.[460] A fiduciary duty may arise in various fiduciary relationships, such as directors and the company, agents, partners, trustees, executors and administrators. This duty is found

[454] Huebner and McCullough, above n 448.

[455] *Gheewalla* 930 A.2d 92, (Del. 2007), 103. The court reasoned that '[t]o recognize a new right for creditors to bring direct fiduciary claims against those directors would create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors. Directors of insolvent corporations must retain the freedom to engage in vigorous, good faith negotiations with individual creditors for the benefit of the corporation.'

[456] Huebner and McCullough, above n 448.

[457] *Trenwick*, 906 A 2d 168 (Del Ch, 2006), 195.

[458] *Lemington*, 659 F 3d 282, 290 (3rd Cir, 2011), 290.

[459] *Gheewalla* 930 A 2d 92, (Del, 2007), 101.

[460] Tamar Frankel, *Fiduciary Law* (Oxford University Press, 2011) 103.

and utilised in many kinds of laws, such as corporation law, labour law and criminal law. A fiduciary duty is applied similarly to different types of laws, although there are some differences.[461] With regard to the business arena, a fiduciary duty is a key concept of corporate law which delineates the responsibilities and rights of directors, managers and shareholders. Sometimes, the fiduciary duties of directors are provided in statutes or judicial opinions.[462] The main element of this duty is 'a requirement to abstain from self-interested behaviour.'[463] However, 'no noneconomic rationale does very well at explaining even the outlines of fiduciary rules.'[464] Consequently, under the 3rd Circuit Court decisions, the courts have long held that when the corporation is 'in the vicinity of insolvency,' directors owe a fiduciary duty to the corporate enterprise[465] and creditors.[466] This statement was confirmed by the judgment in the *Lemington* case.[467]

In summary, the key rationales of directors' fiduciary duties, in the context of an insolvent company derived from US courts' decisions, can be divided into two parts. First, directors owe a fiduciary obligation to exclude personal interests which may affect the company, shareholders and also creditors, particularly when the corporation is approaching insolvency. Second, fiduciary duties of directors forms an important part of corporate governance rules for controlling company directors in operating the company for the benefit of the company, shareholders and creditors. Therefore, the concept of the fiduciary duties of directors could arguably be extended to protect creditors' interests when the company is close to insolvency.

Because of the legal history, described above, and the differences of opinion regarding directors' fiduciary duties, this thesis will not choose to adopt the reasons of any US

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[461] Tamar Frankel, 'Fiduciary law' (1983) 71 *California Law Review* 795, 795.

[462] D Gordon Smith, 'The Critical Resource Theory of Fiduciary Duty' (2002) 55 *Vanderbilt Law Review* 1399, 1459.

[463] Ibid.

[464] Frank H Easterbrook and Daniel R Fischel, 'Contract and Fiduciary Duty' (1993) 36 *Journal of Law & Economics* 425, 436.

[465] *Credit Lyonnais Bank Nederland v Pathe Communications Corp*., WL 2776131, Del 1991, [34].

[466] Russell E Silberglied and Jonathan P Friedland, *Did the Delaware Supreme Court Break the 'Directors' Shield'?* <http://www.lawjournalnewsletters.com/issues/ljn_bankruptcy/24_11/news/149047-1.html>.

[467] The court held that 'these fiduciary duties are owed not only to the corporation and its shareholders, but also to the creditors of an insolvent entity.'

State court but the thesis will examine decisions that consider a specific theory which could provide support for protecting creditors when companies are in the zone of insolvency.

D *Germany*

There is a long history of legal development of dealing with the insolvent trading problem in Germany, just as there is in Australia, the UK and US.[468]

The first law in Germany providing for the protection of the interests of creditors when a company becomes unable to pay its debts was first enacted in 1892 through the *Private Limited Companies Act 1892* (the *Gesetzbetreffend die GesellschaftenmitbeschrankterHaftung 1892*) (‘*GmbHG*’). Section 64 of the *GmbHG* provided the measure for directors when a company is in financial difficulties.[469] The law required managing directors to file for the commencement of bankruptcy proceedings, not later than three weeks after becoming aware of the insolvent state of the company. If directors failed to do so, there was a sanction in tort according to s 823 (2) of the *German Civil Code* (‘*GBG*’). In addition, managing directors must stop making any payment after the occurrence of insolvency or the over-indebtedness is discovered. If not, they would be liable.[470] Bachner claimed that the gist of s 64 was that ‘the violation of the legal norm designed to protect specific interests gives rise to a claim for damages on the part of the protected party.’[471]

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[468] See Michael Beurskens and Ulrich Noack, ‘Of Tradition and Change: The Modernization of the German GmbH in the Face of European Competition’ (2008) *German Law Journal*, 2-8.

[469] The *Private Limited Companies Act 1892* (Germany) section 64 provides that:

(1) If the company becomes insolvent, the managing director shall without undue delay, but not later than three weeks after the insolvency occurs, petition for the commencement of bankruptcy proceeding. The same applies if the assets of the company no longer cover the liabilities. The petition is not culpably delayed if the managing director strives to open the court proceeding with the due care of a prudent businessman.

(2) The managing directors are liable to compensate the company for any payments made after the insolvency has occurred or the overindebtedness is discovered. This does not apply to payments made after the point in time where consistent with due care of a prudent businessman.

[470] Horst Eidenmüller, 'Trading in Times of Crisis: Formal Insolvency Proceedings, Workouts and the Incentives for Shareholders/Managers' (2006) 7(1) *European Business Organization Law Review* 239, 250.

[471] Thomas Bachner, ‘Wrongful Trading: A New European Model for Creditor Protection?’ (2004) 5(2) *European Business Organization Law Review* 293, 299.

This had been used for all related cases regarding insolvency since 1892. In 2006, the Federal Ministry of Justice drafted a bill for an act to modernise the law and to combat abuses. In 2008, the Law for the Modernization of the *GmbH* and to Prevention of Misuse ('*MoMiG*') (The *GesetzzurModernisierung des GmbH- Rechts und zurBekämpfung von Missbräuchen*) entered into force.[472] As well as aiming to enable the provisions in the *GmbHG* to meet modern economic circumstances, the *MoMiG* aimed to increase investments, whether investors were German or foreigners.[473] The main rationales of the reform were to introduce new provisions to extend the boundary of directors' and shareholders' liability. In other words, the rationale of new regulations was about reducing a possibility of insolvency to protect creditors from fraud or negligence in the execution of company business.[474]

The *MoMiG* aims to eliminate the problems of formalities in *GmbHG* and develop statutory rules.[475] The new laws of the reform, in regard to insolvency provisions, were created by the new s 64 of the *Private Limited Companies Act*.[476] Other Acts which relate to company insolvency cases were also reformed as a result of the adoption of MoMiG in 2008, such as the *Insolvency Statute* ('*InsO*').

Two forms of laws control a company's directors in Germany. First, for private companies, laws relating to reckless acts are the *Private Limited Companies Act*

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[472] See also the development history of *MoMiG* in http://gesetzgebung.beck.de/node/182657.

[473] Edward Lestrade, 'Modernising German Limited Liability Companies and the New German Law Relating to GmbH's and on the Fighting of Abuses ('MoMiG') ', *European Newsletter* 2008 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1306206>.

[474] Matthias Casper, 'Liability of the Managing Director and the Shareholder in the Gmbh (Private Limited Company) in Crisis' (2008) 9 *German Law Journal* 1125, 1126.

[475] Michael Beurskens and Ulrich Noack, 'The Reform of the German Private Limited Company: Is the GmbH Ready for the 21st Century' (2008) 9 *German Law Journal* 1069, 1070.

[476] The *Private Limited Companies Act* s 64 specifies:

'Liability for payments following illiquidity or over-indebtedness:

The directors shall be obligated to compensate the company for payments made after the company has become illiquid or after it is deemed to be over-indebted. This shall not apply to payments which, after this point in time, are compatible with the due diligence of a prudent businessman. The same obligation shall affect the directors in regard to payments to shareholders if these led to the company becoming illiquid, unless this was not recognisable whilst observing the due diligence referred to in the second sentence. Section 43 (3) and (4) shall apply mutatis mutandis to a claim for compensation.'

1892,[477] the *InsO*[478] and the *German Civil Code*.[479] Second, for public companies, the *German Stock Corporation Act 2010*[480] ('*AktG*') also makes provisions to deal with insolvent trading.

For example, s 64 of *the Private Limited Companies Act* provides a duty for reimbursement by directors in cases when they make any payment after the company has become illiquid or after it is deemed to be over-indebted. This duty is extended to shareholders according to s 64 sentence 3. Moreover, s 15a[481] of the revised *InsO* also provides that the member of the board of directors has a duty to file for insolvency. Managing directors are obligated to file a request for instigating insolvency proceedings without culpable delay.[482] There are also criminal penalties for managing directors and management boards who fail to comply with this duty.[483]

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[477] Last amended on 23 July 2013 (*Federal Law Gazette* I p 2586).

[478] Last amended on 20 December 2011 (*Federal Law Gazette I* p 2854).

[479] Last amended on 27 July 2011 (*Federal Law Gazette I* p 1600).

[480] Last amended on 9 December 2010 (*Federal Law Gazette I* p 1900).

[481] The *Insolvency Statute 1994* (Germany) s 15a states:

'Obligation to request in the case of legal persons and associations without legal personality:

(1) Where a legal person becomes illiquid or overindebted, the members of the board of directors or the liquidators shall file a request for the opening of proceedings without culpable delay, at the latest, however, three weeks after the commencement of insolvency or overindebtedness. The same shall apply to the organ representatives of the partners authorized to represent the company or the liquidators in the case of a company without legal personality where none of the general partners is a natural person; this shall not apply if one of the general partners is another company in which a general partner is a natural person.'

(2) In the case of a company within the meaning of subs (1), second sentence, subs (1) shall apply correspondingly if the organ representatives of the partners authorized to represent the company are, in turn, companies in which none of the general partners is a natural person, or the grouping of companies continues in this way.

(3) Where a private limited company lacks a management, each partner, in the case of lack of management of a public limited company or a cooperative each member of the supervisory board, is also obligated to file a request, unless that person is not aware of the insolvency or overindebtedness or the lack of management.

(4) Whoever, contrary to subs (1), first sentence, also in conjunction with the second sentence or subs (2) or subs (3), does not file a request for the opening of proceedings, does not correctly file a request or does not file a request in good time shall be punished with imprisonment for not more than three years or a fine.

(5) If the perpetrator under subs (4) acts negligently, the punishment shall be imprisonment for not more than one year or a fine.'

[482] The *Insolvency Statute 1994* (Germany) s 15a (1) and (3).

[483] Valentin Todorow, *Update Recent Amendments to Insolvency Law* <http://www.hoganlovells.com/files/Publication/3afa3153-b25a-484b-a448-

The *InsO* also applies to a public company. It provides the same measure for board directors to initiate insolvency proceedings without undue delay.[484] Moreover, the *AktG* also states that if the company has incurred a loss equal to one half of share capital, the board of directors (called the managing directors) has a duty to call shareholders for an extraordinary general meeting.[485] If the company becomes insolvent or over-indebted, the management board may not make any payments, according to s 92(2) of the *AktG*. Furthermore, s 401 subs (1) of the *AktG* states:

> 'Whoever, as a member of the management board, in violation of s 92 (1) fails to call a shareholders' meeting and to disclose at such meeting a loss equal to or exceeding one-half of the share capital shall be punished by imprisonment of up to three years or by a fine.'

Wood argued that the rationales of provisions under *AktG* regarding the protection of creditors' or injured persons' interests were that the duty to initiate insolvency proceedings according to *AktG* could be a safeguard for creditors in several ways. First, directors cannot operate the company as if they are betting, especially when the company is unable to pay its debts. Next, the creditors will notice the financial situation of the corporation before it is too late for rescue. Last, 'by initiating insolvency proceedings quickly, this measure preserves the priority of payment established by the insolvency regime, preventing payments to preferred creditors.'[486]

In summary, the rationale behind statutory provisions enacted in Germany is to protect creditors' interests, particularly when the corporation is unable to pay its debts or becomes insolvent. In addition, it also aims to extend the boundary of directors' and shareholders' liability.

272f7f617688/Presentation/PublicationAttachment/039f2bd0-11d3-4906-9cb5-52de8799732a/German%20Update_InsolvencyLaw_Eng_Dec2008.pdf>.

[484] The *Insolvency Statute 1994* (Germany) s 15a

[485] The *AktG* s 92(1)

[486] Justin Wood, 'Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany, and Japan' (2007) 26 *Penn State International Law Review* 139, 156.

All in all, it can be said that the issue of operating a business, when a corporation is approaching insolvency or is becoming insolvent, is recognised in all the countries discussed above. Some countries have provided specific statutory rules or a principle to resolve the problem of insolvent trading since the 19th century; other countries have only recently revised and developed their laws to deal with the problem. However, in regard to insolvent trading, all countries reviewed above have specific provisions or measures to protect the rights of creditors and restrain insolvent trading. Trading in difficult financial times must be controlled and carefully investigated. Therefore, it is not surprising that each country has its law to protect creditors' interests. Even though the backgrounds and rationales of each country's laws are different, the core aims of theory or principle are the same. In other words, the main reason for the laws to prevent insolvent trading is to protect creditors' and other related persons' interests prior to official declaration with respect to directors' decisions.

E. *The UNCITRAL Legislative Guide*

Investigating company directors' responsibilities and liabilities in insolvency and pre-insolvency cases was first proposed by the UK,[487] INSOL International[488] and the International Insolvency Institute[489] to UNCITRAL[490] in the early 2000s. UNCITRAL began its work on the subject in 2010. After five sessions of an extensive study, the Working Group V of UNCITRAL finished its work and the *Legislative Guide on Insolvency Law Part Four: Directors' obligations in the period approaching insolvency* was proposed.[491] However, the Guide specifically focused 'only on those

[487] Insolvency Law: Possible future work, UN GAOR, 38th sess, A/CN.9/WG.V/WP.93/Add.4 (19-23April 2010).
[488] Insolvency Law: Possible future work, UN GAOR, 38th sess, A/CN.9/WG.V/WP.93/Add.3 (19-23 April 2010).
[489] Insolvency Law: Possible future work in the area of insolvency law, UN GAOR, 38th sess, A/CN 9/582/Add 6 (4-15 July 2005).
[490] Report of Working Group V (Insolvency Law) on the work of its thirty-eight session, UN GAOR, 43rd sess, A/CN 9/691 (21 June-9 July 2010), 19.
[491] Report of Working Group V (Insolvency Law) on the work of its forty-third session, UN GAOR, 46th sess, A/CN.9/776 (8-26 July 2013), 15.

obligation that may be included on the law relating to insolvency and become enforceable once insolvency proceedings commence.'[492]

The rationales for imposing directors' obligations in the period approaching insolvency can be found in the *UNCITRAL Legislative Guide on Insolvency Law*. First, similar to the rationale of various insolvency and corporate laws discussed above, such obligations aim 'to protect the legitimate interests of creditors and other stakeholders.'[493] The second rationale concerns providing an incentive to minimise potential loss when a company is in financial difficulty.[494] According to the Guide, effective regulation of insolvent trading can also be used to promote the development of good corporate governance principles at the domestic and international levels.[495] Furthermore, such regulation aims to balance the competing goals and interests between directors, shareholders and creditors.[496] However, there are some shortcomings to requiring directors to have obligations to creditors and others in the period when a company is approaching insolvency. For instance, imposing directors' liability when a company is nearing insolvency may lead to obstructing or impeding a competent or knowledgeable person for being a company director. Moreover, a company may miss opportunities for reorganisation or returning to profitability if it is closed prematurely to avoid directors' liability. Lack of commercial experience by courts can also be a problem for making a decision about such situations.[497]

Nevertheless, the UNCITRAL provides some recommendations regarding directors' obligations when a company is in danger of becoming or becomes insolvent as reference points by which policymakers can examine and apply it for developing their

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[492] UNCITRAL, *UNCITRAL Legislative Guide on Insolvency Law: Part Four: Directors' Obligations in the Period Approaching Insolvency* (United Nations, New York, 2013) 8.

[493] Ibid 1.

[494] Ibid.

[495] Ibid 3, 8.

[496] Ibid 8. The details in rationales of *Legislative Guide on Insolvency Law* can be found in *UNCITRAL Legislative Guide on Insolvency Law Part four: Directors' Obligations in the Period Approaching Insolvency* [1]-[15].

[497] Ibid 6.

legal and regulatory frameworks.[498] The recommendations in the *Legislative Guide on Insolvency Law* will be explained next.

In summary, the insolvent trading provisions have been criticised in many ways. For example, the provisions can deter a qualified person for being a company director or company directors may prematurely close a company to avoid liability. Furthermore, the provisions are not fair to a director because creditors should be protected by having insurance, a contract or even a personal guarantee from directors. However, having insolvent trading provisions can prevent a company from trading while insolvent. Moreover, creditors will have a great shield to protect their interests. Especially, unlike secured creditors, unsecured creditors will have more protection because they are not put in a first priority for payouts when a company becomes insolvent. In addition, the insolvent trading provisions can increase awareness of a company director, particularly when a company is in financial distress. Therefore, it is reasonable to argue that insolvent trading provisions are required for protection of creditors' interests under Thai laws.

III *INSOLVENT TRADING RESOLUTIONS*

As discussed in Chapter 3, Thai corporate law still has many problems regarding insolvent trading. Creditors and investors do not have enough legal protection, particularly in the case of an insolvent company. Developed countries, such as the UK, Australia, the US and Germany, have specific provisions or an appropriate theory to solve the problem of insolvent trading. Also the UNCITRAL provides guidance to deal with insolvent trading for member states. This section will discuss legal provisions and the legislative guideline provided by the UNCITRAL in order to examine their appropriateness as a basis for reforming of Thai corporate and insolvency laws.

Specifically, with regard to Thai legislation, the five problems as identified in Chapter 3 need to be discussed: the definition of directors; the problem concerning the absence of a specific duty of directors to prevent insolvent trading; the issue of the insufficiency

[498] Ibid 8.

directors' liability; the issue of reorganisation: and the question of duty of directors when a company is in an insolvent state. The first four problems will be discussed in the following section and Chapter 5 will discuss directors' duty when a company is in an insolvent state.

A *Definition of Director*

There is no definition of what constitutes a director under Thai laws, including no clarity on whether 'director' includes a *de facto* or shadow director. The law notes only that '[a] director can be appointed or removed only by a general meeting.'[499] Thai courts have ruled that director means only executive and non-executive directors. The meaning of director does not include *de facto* and shadow directors; however, many companies are controlled by these types of directors. Particularly in the case of insolvent trading, the *de facto* and shadow directors who control or manage a corporation should be liable for any damages affecting the interests of creditors and third parties. For this reason, Thai corporate laws need to incorporate a concrete definition of director and expand the current accepted meaning of director by including *de facto* and shadow directors in the definition of a director.

The UK and Australia define directors, but neither the US nor Germany do.[500] In this section, therefore, only the definition of a director as provided by the UK and Australia will be discussed.

As noted in Chapter 3, a problem with Thai corporations laws is that Thai courts strictly adhere to literal or black letter law interpretations, making it imperative to incorporate a concrete definition of director in order to be able to hold to account all forms of directors, whether *de facto* directors or shadow directors, who are involved with the operations of a company that is approaching insolvency.

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[499] *CCC* s 1151.

[500] Neither the *Model Business Corporation Act*, which is an influential law adopted by 24 states in the US nor the *Delaware Code*,define directors. In Germany, neither the *GmbHG* or the *AktG* specify the meaning of directors.

The UK *Insolvency Act 1986* s 214 (2) (c),[501] states that the wrongful trading provision is applied to a director. The meaning of directors can be found in s 250 of the *Companies Act 2006*, as '[i]n the *Companies Acts* "director" includes any person occupying the position of director, by whatever name called.'

The UK courts have subsequently interpreted the meaning of director by examining the facts and circumstances of each case and do not place undue emphasis on a person's title.[502] Moreover, the courts make no distinction between executive directors and non-executive directors. Thus, both kinds of directors can be held to account in circumstances of wrongful trading. In terms of a *de facto* director, according to the decision of Millett J in the *Corby* case, it was argued that:

> Liability cannot sensibly depend on the validity of the defendant's appointment. Those who assume to act as directors and who thereby exercise the powers and discharge the functions of a director, whether validly appointed or not, must accept the responsibilities which are attached to the office.[503]

Therefore, the definition of director under s 250 of the *Companies Act 2006* means de jure and *de facto* directors. Nevertheless, there is no certain test to verify whether or not a person is a *de facto* director. Keay claims that to identify a person as a *de facto* director, the UK court should consider:

(a) whether there was a holding out of the person as a director

(b) whether the person used the title;

(c) whether the person had proper information on which to base decisions; and

(d) whether the person had to make major decisions.[504]

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[501] The *Insolvency Act* 1986 (UK) s 214 (2) provides that:
'(2)This subs applies in relation to a person if …
(c) that person was a director of the company at that time; but the court shall not make a declaration under this s in any case where the time mentioned in paragraph (b) above was before 28th April 1986.'

[502] John Barlow, *Directors' and Officers' Liability; The Legal Position in The United Kingdom* Chadbourne & Parke Regis House <http://www.chadbourne.com/files/upload/DandOLiability.pdf>.

[503] *Re Hydrodam (Corby)* Ltd (1994) B.C.C. 161, [162]. ('*Corby*')

[504] Keay (2007), above n 303, 6.

Shadow directors are included in the wrongful trading provision.[505] The shadow directors' meaning is stated in the *Companies Act 2006* s 251 as:

> "Shadow director"
>
> (1) In the Companies Acts "shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act
>
> (2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.
>
> (3) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of—
>
> Chapter 2 (general duties of directors),
>
> Chapter 4 (transactions requiring members' approval), or
>
> Chapter 6 (contract with sole member who is also a director),
>
> by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.

A juristic person, therefore, can be included as a shadow director.[506] However, 'a person will not be a shadow director if the directors act on advice given by that person in a professional capacity.'[507]

In summary, a director who has a duty to avoid wrongful trading is a *de jure* director, *de facto* director or shadow director. The meaning of a director includes executive and non- executive directors.[508] Moreover, in wrongful trading provisions, a shadow director can be liable if his corporation is involved in wrongful trading.

It is important to note that s 214 of *The Insolvency Act* applies only to directors. Although the *Cork Report* intended to attach liability to anyone who is actually a party to the company's carrying on of the offending business, this recommendation was not

[505] The *Insolvency Act 1986* (UK) s 214(7).

[506] Keay (2007), above n 303, 7.

[507] Barlow, above n 502.

[508] Anupong Duchanee, *Legal Problems Concerning Transaction Committed by Directors While the Company is Insolvent* (Degree of Master of Law Thesis, Ramkhamhaeng University, 2002), 82.

taken up by the UK government.[509] Keay claims that other countries which have a similar provision, for example, in Ireland (s 297A of the *Companies Act 1963*), a person, who is an officer including an auditor, liquidator, receiver and director, can be held liable for reckless trading. In Singaporean legislation, s 339 under the *Companies Act 1990* provides a measure to deal with insolvent trading. The law imposes liabilities on persons who are the 'company secretary, persons employed in an executive capacity by the company, receivers and liquidators.'[510]

Under Australian corporate law, the meaning of director is imposed by s 9 of the *Corporations Act 2001* (Cth).[511] Under s 588G, directors can be *de jure* directors, *de facto* directors[512] or shadow directors.[513] A *de facto* director is someone acting as a director although he or she is not validly appointed or not described as a director.[514] 'A shadow director is a person in accordance with whose instructions or wishes the directors of the company are accustomed to act.'[515] In certain situations a person could be assumed to be a director who conducts the company business.[516] As well, the definition pursuant to s 9 could include an alternate director if called upon to act.[517]

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[509] *Cork Report*, above n 305, [1787].

[510] Keay (2007), above n 303, 87.

[511] The *Corporations Act* s 9 states that director of a company or other body means:

'(a) a person who:

(i) is appointed to the position of a director; or

(ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position; and

(b) unless the contrary intention appears, a person who is not validly appointed as a director if:

(i) they act in the position of a director; or

(ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.

Subparagraph (b)(ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.'

[512] See also *Taylormaid Marine Industries Pty Ltd v Beaurepaire & Ors* (1987) 5 ACLC 253, *Williams v Bearing Traders Pty Ltd* [2008] NSWSC 1358, (2008) 69 ACSR 334 and *Xie v Crisp* (2011) 248 FLR 265.

[513] See Pamela F Hanrahan, Ian M Ramsay and Geof Stapledon, *Commercial Applications Of Company Law 2014* (CCH Australia, 15th ed, 2014), 251.

[514] James, Ramsay and Siva, above n 378, 5.

[515] Ibid.

[516] The *Corporation Act 2001* (Cth) s 129.

[517] See *Playcorp Pty Ltd v Shaw*, (1993) 10 ACSR 212, 11 ACLC 641.

These provisions indicate that those who are considered directors and who have a duty to prevent insolvent trading under s 588G of the *Corporation Act 2001* (Cth) is quite broad.

For instance, the conundrum regarding shadow directors should be considered. Even though s 9 exempts direct responsibility by those who act as professional advisor or have a personal business relationship, some advice may undeniably lead to an instruction. Thus, Coburn argues that '[c]oncern has been raised whether or not advice in certain circumstances can amount to "instruction".'[518]

Prior to the reform,[519] a person liable for insolvent trading was not only a person who was a *de facto* or de jure director but also a person who was concerned in the management of the insolvent company.[520] The Australian court in *3M Australia Pty Ltd v Kemish*[521] ruled that a consultant, who truly controlled the company's finances and was concerned in the management of the firm, was liable for insolvent trading. Therefore, it seems likely that any advice given by banks or financial institutions may be an instruction which may be interpreted as an action such as those of shadow directors, and they will be liable under insolvent trading law.[522]

After reform, even though s 588G does not embed a phrase concerning the liability of persons who are involved in a management role, the wide definition of directors still contained in s 9 of the *Corporations Act*. The director's definition can be implied to *de jure* and *de facto* directors who are part of company management. Therefore, both types of directors can be applied under s 588G. For instance, in *Williams v Bearing Traders Pty Ltd*,[523] the court held that, even though the director claimed that he resigned from the director's position before the company became insolvent, there was clear evidence showing that he still had an involvement with the company, such as acting as a director

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[518] Coburn, above n 344, 93.

[519] The *Corporate Law Reform Act 1992* (Cth) s 592 (1). This section was repealed and replaced by s 588G of the *Corporation Act 2001* (Cth).

[520] G Syrota, 'Insolvent Trading: Hidden Risks for Accountants and Banks Participating in Work Outs' (1993) 23 *University of Western Australia Law Review* 329, 332.

[521] *3M Australia Pty Ltd v Kemish* (1986) 4 ACLC 185.

[522] Syrota, above n 520, 334.

[523] *Williams v Bearing Traders Pty Ltd* (2008) 69 ACSR 334; (2008) NSWSC 1358.

when the trading time had come whilst the company was insolvent. This means that he still carried out the duty of director and his resignation letter was nothing more than self-serving. Therefore, Kirby J ruled that the director was liable to the creditor for insolvent trading under s 588G.[524]

In addition, holding companies or financial institutions, that is, other juristic persons, can be interpreted as shadow directors if they act in the position of a director whilst the company becomes insolvent.[525] As a result, s 588V of the *Corporation Act 2001* (Cth) imposes liability on a holding company for the debts of an insolvent subsidiary. This section is designed to protect creditors in relation to the incurring of a debt by a subsidiary when it is insolvent.[526] Moreover, other persons may be assumed to be directors pursuant to s 129 of the *Corporations Act 2001* or to be alternate directors. The broad definition can be viewed as an advantage to creditors for claiming the liability of directors with respect to insolvent trading, giving creditors a shield to protect their interests.

The *UNCITRAL Legislative Guide on Insolvency Law*, in recommendation 258, provides:

> The law relating to insolvency should specify the person owing the obligations … which may include any person formally appointed as a director and any other person exercising factual control and performing the functions of a director.[527]

This definition would include *de facto* and shadow directors but advisers will not be considered within the group of persons having an obligation.[528] The definition under the UNCITRAL Guide, thus, is similar to that of the UK and Australian directors' definitions. Although it may be simpler, the author of this thesis proposes that is better

[524] Ibid, 75.
[525] See Alex Wong, *Student Guide to Company Law* (Wolters Kluwer, 2014) 125.
[526] Ian Ramsay, 'Holding Company Liability for the Debts of an Insolvent Subsidiary: a Law and Economics Perspective' (1994) 17(2) *UNSW Law Journal* 520, 522.
[527] UNCITRAL (2013), above n 492, 18.
[528] Ibid 17.

to consider the precise definition of director as shown in the UK and Australian laws in formulating a provision for Thailand.

Table 4.1and 4.2 provide a summary of the varied definitions of director and shadow director.

Table 4.1: Meaning of directors under UK and Australian laws

Country	Meaning of directors
The United Kingdom	**In the *Companies Act* 'director' includes any person occupying the position of director, by whatever name called.** **(s 250 of the *Companies Act 2006*)**
Australia	**Director of a company or other body means:** **(a) a person who:** **(i) is appointed to the position of a director; or** **(ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position; and** **(b) unless the contrary intention appears, a person who is not validly appointed as a director if:** **(i) they act in the position of a director; or …** **(s 9 of the *Corporations Act 2001*)**

Even though the meaning of directors in both countries means *de jure* directors and *de facto* directors, the definition under Australian law is classified so a person called a director is clearer than that of the UK law. An explicit definition can reduce the need for interpretation by Thai courts, which take a literal or a black letter law approach which allows them to simply apply the law making only those specified in the law to be liable for insolvent trading.

With regard to a definition of shadow directors, Table 4.2 shows the difference in definitions between the UK and Australian laws.

Table 4.2: Meaning of shadow directors under UK and Australian laws

Country	Definition of shadow directors
The United Kingdom	**(1) In the *Companies Act* "shadow director", in relation to a company, means a person in accordance with whose**

	directions or instructions the directors of the company are accustomed to act **(2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.** **(3) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of—** **Chapter 2 (general duties of directors),** **Chapter 4 (transactions requiring members' approval), or** **Chapter 6 (contract with sole member who is also a director),** **by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.** **(s 251of the *Companies Act 2006*)**
Australia	**(b)(ii) the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes.** **Subparagraph (b) (ii) does not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person's professional capacity, or the person's business relationship with the directors or the company or body.** **(s 9 (b)(ii) of the *Corporations Act 2001*)**

It should be noted that the holding company may also be liable for the subsidiary's insolvent trading if it has acted as a shadow director of the subsidiary company under s 251of the *Companies Act* (UK) and s 588G of the *Corporations Act*. However, the *Corporations Act* goes further than the *Companies Act* (UK) by directly imposing liability on a holding company to pay compensation for insolvent trading by a subsidiary under s 588V.[529] Thailand requires a defined meaning for 'director', '*de facto'* and 'shadow director' in order to control insolvent trading, while the company

[529]Robert Austin and Ian Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, 16th ed, 2015), 1242. See also, *In dustrial Equity Ltd v Blackburn* (1997) 137 CLR 567 and the UNCITRAL Working Group V (Insolvency Law), Insolvency Law: Directors' obligations in the period approaching insolvency: enterprise groups, UN GAOR, 47th sess, A/CN.9/WG.V/WP.129 (26-29May 2015) which deals with 'the specific issues that might affect the obligations of directors who perform that function for one or more enterprise group members'.

is approaching insolvency without caring for the creditors' interests can occur by the instruction of directors, *de facto* or shadow directors. As explained above, an explicit definition can remove the need for interpretation by Thai courts, which take a literal or a black letter law which allows them to simply apply the law making only those specified in the law to be liable for insolvent trading. Thus, in the view of the researcher, Australian law rather than UK law appears to be the better model for Thailand because of its greater clarity.

Given the importance of shadow directors in Thailand, a definition of shadow directors would be a useful legal tool for creditors. By adopting an expansive definition of a director, the UK and Australian legislation enables shadow directors who engage in insolvent trading provisions to be caught by the provisions. However, the definition of shadow directors should also contain an exemption for a person who gives advice as an expert. A reason is that an expert can suggest something to a company director without fear of insolvent trading provisions. For example, s 251 (2) of the *Companies Act 2006* of the UK states that 'a person is not to be regarded as a shadow director by the only reason that the directors act on advice given by him in a professional capacity.' Thus, lawyers or accountants giving advice to a company director are not shadow directors.[530]

B *Duties to Prevent Insolvent Trading*

The UK, Australia, the US and Germany all have specific provisions or a theory to deal with the problem of trading when the company becomes insolvent. Similarly, the UNCITRAL provides legislative guidelines for member states to control the problem of insolvent trading. In considering the laws from these various countries and the UNCITRAL guidelines, it is evident that Thailand should also include appropriate provisions, perhaps modelled on those of other countries, to prevent insolvent trading and protect creditors' interests under the Thai jurisdiction. Consequently, the thesis will first clarify the provisions or the theory dealing with the insolvent trading problem of each country; and then the legislative guidelines of UNCITRAL will be used to help

[530] This section is similar to s 9 subparagraph (b) (ii) of the *Corporation Act* (Cth).

determine the similarities and differences at the domestic and international levels. Following the discussion on comparisons, recommendations for the adoption of appropriate provisions will be made, especially those that acknowledge Thai's unique business culture.

Table 4.3 summarises the theory and the provisions applied to solve the insolvent trading issue under various jurisdictions. Each provision or theory has particular conditions for applying it.

Table 4.3: Provisions and theory to prevent insolvent trading

Country	Provisions and Theory
The United Kingdom	**S 214 of the *Insolvency Act 1986***
Australia	**S 588 G of the *Corporation Act 2001***
The United States	**The fiduciary duty theory**
Germany	**S 64 of the *Private Limited Companies Act 1892*** **S 92 of the *German Stock Corporation Act 2010*** **S 15a of the *Insolvency Statute***

The United Kingdom

The UK *Insolvency Act 1986*, especially s 214, imposes a duty on directors to avoid wrongful trading.[531]

[531] *The Insolvency Act 1986* (UK) s 214 Wrongful trading provides that:

(1) Subject to subs (3) below, if in the course of the winding up of a company it appears that subs (2) of this s applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.

(2) This subs applies in relation to a person if—

(a) the company has gone into insolvent liquidation,

(b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and

(c) that person was a director of the company at that time; but the court shall not make a declaration under this s in any case where the time mentioned in paragraph (b) above was before 28th April 1986.

(3) The court shall not make a declaration under this s with respect to any person if it is satisfied that after the condition specified in subs (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.

A primary concern of company directors is to avoid financial failure.[532] According to s 214 of the *Insolvency Act 1986*, the director's duty to avoid wrongful trading includes three primary conditions: (1) the company has gone into insolvent liquidation; (2) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and (3) that person was a director of the corporation at that time.[533]

For the first condition, the meaning of insolvent liquidation is clarified in s 214 (6) that a corporation 'goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.' Section 214 (6), therefore, applies the balance sheet test rather than the cash flow test.[534]. The balance sheet test is used to compare the value of a company's assets to its liabilities. A test of the possibility of debts payment and the period of time when the company's debts come due is the cash flow test.[535] Note that the first condition of s 214 is that if the firm has not entered into insolvent liquidation or is not insolvent pursuant to the meaning provided in s 214 (6), this section will not be applied to directors.[536]

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(4) For the purposes of sub ss (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has.

(5) The reference in subs (4) to the functions carried out in relation to a company by a director of the company includes any functions which he does not carry out but which have been entrusted to him.

(6) For the purposes of this s a company goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.

(7) In this s "director" includes a shadow director.

(8) This s is without prejudice to s 213.

[532] Tahir Ashraf, 'Directors' Duties with a Particular Focus on the Companies Act 2006' (2012) 54(2) *International Journal of Law and Management* 125, 134.

[533] The *Insolvency Act 1986* (UK) s 214 (2)(a) (b) and (c).

[534] Keay (2007), above n 303, 86.

[535] John B Heaton, 'Solvency Tests' (2007) 62 *The Business Lawyer* 983, 983.

[536] Keay (2007), above n 303, 86.

British courts also employ the cash flow test to determine whether a corporation has a reasonable prospect of avoiding insolvent liquidation, even though the law implies that the balance sheet test shall be applied to indicate a company's financial status. For example, in *Re Purpoint*,[537] the courts held that, even though the company was undoubtedly insolvent on a balance sheet test when it began trading in 1998, company directors did not breach s 214 until the end of that year because only then was it clear that 'the company could not meet its trade debts as they fell due.'[538] Also, in *Re Rod Gunner Organisation*,[539] Etherton J confirmed that company directors will not contravene s 214 only by reason that a company is insolvent on a balance sheet basis.[540] Thus, Davies concluded that, 'it is further clear that the cash flow test is applied on a commercial reality basis.'[541] In fact, if the company is solvent on a cash flow basis, there is no need for creditors to put the company into liquidation. Therefore, directors can claim that there is a reasonable prospect to avoid insolvent liquidation.[542]

The second essential condition can be considered separately in terms of (1) a director knew or ought to have concluded that there was no reasonable prospect that a firm would avoid going into insolvent liquidation; and (2) at some time before the commencement of the company's winding up.

First, the purpose of the legislation, concerning the fact that a director knew or ascertained that there was no reasonable prospect for a company to avoid insolvent liquidation, is set out in s 214 (4):

> For the purposes of subsection (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both:

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[537] *Re Purpoint Ltd* [1991] BCLC 491.
[538] Ibid, [128].
[539] *Re Rod Gunner Organisation Ltd* (2004) EWHC 316 (Ch), (2004) 2 BCLC 110.
[540] See also David Kershaw, *Company Law in Context: Text and Materials* (Oxford University Press, 2nd ed, 2012), 797-798.
[541] Davies, above n 37, 319.
[542] Ibid, 320.

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has.

In considering this section, Payne and Prentice claim that there are two standards imposed. Subsection (a) sets the floor as the objective standard. The ceiling is set in subsection (b) as the subjective standard.[543] Therefore, directors in the UK will be considered regarding wrongful trading using both subjective and objective standards.

Generally, directors must have general knowledge, skill and experience as listed in subsection (a). This element can refer to the fact that the objective standard can be interpreted to apply with the reasonably diligent person. Thus, the minimum standard applied to directors in the UK is a reasonably diligent person. The subjective standard is also applied to directors.[544] The general knowledge, skill and experience that a director has according to subsection (b) is specific to individual directors. Certainly directors who have experience and skill will take more risk in relation to being liable for breaches of duty to prevent wrongful trading. However, if a director has only a few years of experience in operating a company or if his or her standard has not reached the minimum standard (of a reasonably diligent person), 'he or she is not able to take advantage of that fact and be protected from liability.'[545]

For instance, *in Re Brain D Pierson (Contractors) Ltd*,[546] the court held that a company director has a certain minimum responsibility and function. He or she cannot be a 'sleeping director'; as well, ignorance cannot be an excuse for that person to avoid liability.[547] Moreover, Williamson QC stated:

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[543] Payne and Prentice, above n 38, 200.

[544] Zipora Cohen, 'Directors' Negligence Liability to Creditors: A Comparative and Critical View' (2000) 26 *The Journal of Corporation Law* 351, 384-385. Cohen claims that '[a] director who does not meet the minimal, objective standard will not receive protection even if he did the best he could.'

[545] Keay (2007), above n 303, 88-89.

[546] *Re Brain D Pierson (Contractors) Ltd* (1999) BCC 26.

[547] Ibid [55].

> In my judgment this paragraph is indicating only that where a director performs a special function, such as 'finance director' or 'marketing director,' then the special skills expected of a person in that capacity are to be expected of him. The paragraph cannot be used to reduce the basic standard required on the grounds that the director in question exercised no particular function in the company's management.[548]

To be a director in the UK, even if a person has not much experience in operating a company, he or she also has definitely been measured at least by the objective or minimum standard. Thus, execution of directors under s 214 of the *Insolvency Act 1986*, whether a director has more or less experience, must reach the minimum standard of a director, which is called the reasonably diligent person standard, and which is an objective standard. The subjective test is also applied to a director according to 214 (b). The level of liability or standard to measure a director, therefore, can be different. It depends on the experience of each director.

Indicating the exact time before the commencement of the winding up of the company when there was no reasonable prospect to avoid insolvent liquidation is the most difficult part for liquidators to 'define and prove in a particular factual situation at what point there was no reasonable prospect of the company avoiding insolvent liquidation.'[549] Because of the absence of the definition of 'reasonable prospect,' it seems that directors in the UK would be liable to the company automatically. There are many probable approaches leading to company insolvency.[550]

Re Produce Marketing Consortium Ltd.[551] was the first reported case in which a court had to consider the issue of when directors ought to have ascertained that a corporation would not avoid going into insolvent liquidation because of no reasonable prospect.[552] The company, having two directors, acted as an agent on a commission basis for an

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[548] Ibid.
[549] Hirt, above n 40, 91.
[550] Payne and Prentice, above n 38, 200.
[551] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.
[552] Andrew Campbell, 'Wrongful Trading and Company Rescue' (1994) 25 *Cambrian Law Review* 69, 72.

importation business; the firm imported fruit from overseas into the UK. In 1984–1986 the company traded while its overdraft grew continuously as well as having an excess of liabilities over assets. The company became insolvent and went into creditors' voluntary liquidation on 2 October 1987.

Knox J held that, in this case, there was no claim regarding the problems of who was a director of the company and whether the company had gone into liquidation. However, the important issue was that of when the directors should have known or ought to have concluded that there was no reasonable prospect that the firm would avoid going into insolvent liquidation. Thus the court could not inevitably concede that this issue has to be considered with subsection four of s 214. This means that, to consider the timing that there was no reasonable prospect, the general knowledge, skill and experience of the individual director was considered.[553] Company accounts are statements which directors must accurately prepare, that is, directors have duties in regard to the company accounts in various ways, such as preparing a profit and loss account for each financial year or doing the balance sheet test at the end of the year. However, there was evidence, in this case, that 'the preparation of accounts was woefully late'.[554] The directors argued that the accounts were not in their hands until January 1987. Knox J, therefore, made a decision that 'the date on which liability under s214 commenced was the date when the accounting information should have been available.'[555] The fact that the company accounts were not in the directors' hands was immaterial.

Thus, section 214 (2) (b), standards of duty of directors pursuant to subsections (4) (a) and (b) indicate that the suitable time means some time before the commencement of

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[553] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569, [593].

[554] Ibid, [595]. Knox J claimed that 'the knowledge to be imputed in testing whether or not directors knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation is not limited to the documentary material actually available at the given time. This appears from sec. 214(4) which includes a reference to facts which a director of a company ought not only to know but those which he ought to ascertain, a word which does not appear in sec. 214(2)(b). In my judgment this indicates that there is to be included by way of factual information not only what was actually there but what, given reasonable diligence and an appropriate level of general knowledge, skill and experience, was ascertainable.'

[555] Campbell, above n 552, 73.

the company's winding up when there was no reasonable prospect to avoid the insolvent liquidation. However, this case did not indicate the exact time to apply s 214 of the *Insolvency Act 1986*. Oditah opined that the reasonable prospect phrase is elusive. Oditah, moreover, also suggested that 'the question whether directors ought reasonably to conclude that their company has no reasonable prospect of avoiding insolvent liquidation so as to avoid liability… can only be answered by identifying the cause of the particular insolvency.'[556]

This is a reason why many scholars agree that it is difficult to identify the starting time of directors' liability according to the *Insolvency Act 1986* s 214. It is not surprising UK courts indicate the starting point of time under s 214 in various ways; the beginning of the directors' liability depends on individual circumstances. The liquidators need to strike a balance between the possibility of the corporation in relation to becoming insolvent and the awareness of directors that it will not lead to avoiding insolvent liquidation. Who is responsible among company directors according to the last condition of s 214, depends upon the meaning of directors and has already been discussed above.

Australia

Directors' duties under Australian corporate law derive from general and statutory law:[557]

1. Fiduciary and common law duties refer to the duty to act in good faith in the interests of the company, the duty to act for proper purposes, the duty to avoid a conflict of interest and the duty to exercise care and skill.
2. Statutory duties consist of the duty to act with reasonable care (s 180(1) of the *Corporations Act 2001* (Cth)), the duty to act in good faith in the best interests of the company and for a proper purpose (s 181 of the Act), the duty not to make improper use of position (s 182 of the Act), the duty not to make improper use of company information (s 183 of the Act), the duty to make full disclosure of

[556] Oditath in Keay, above n 303, 93.
[557] Austin and Ramsay, above n 529, 419-420.

personal material interest (s 191 of the Act) and, finally, the duty to avoid insolvent trading (s 588G of the Act). Under s 588G (1),[558] directors have duties to prevent insolvent trading, and s 588G (2) specifies the circumstances under which a director contravenes the Act.[559]

Section 588G imposes a duty on directors to prevent insolvent trading by their company: subsection (1) determines the application of this section, and subsections (2) and (3) set out the circumstances in which directors fail or contravene the section and the circumstances in which directors commit offences, respectively.[560]

The conditions in s 588G (1) are:

- A person is a director when the company incurs a debt
- The company is insolvent or becomes insolvent by incurring a debt
- There are reasonable grounds for suspecting that the company is insolvent or becomes insolvent
- That debt was incurred at or after the commencement of the Act

Who can be counted as a director of a company has already been discussed above. However, it may be useful to clarify the meaning of 'insolvent' and 'incurring a debt' to better understand the purpose of the section.

Section 95A of the *Corporations Act 2001* defines insolvency[561] simply as the condition in which a company is unable to pay all its debts 'as and when they are due

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[558] The *Corporations Act 2001* s 588G states:

(1) This section applies if:

(a) a person is a director of a company at the time when the company incurs a debt; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and

(d) that time is at or after the commencement of this Act.

[559] The *Corporations Act 2001* s 588G provides that:

(2) By failing to prevent the company from incurring the debt, the person contravenes this section if:

(a) the person is aware at that time that there are such grounds for so suspecting; or

(b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

[560] Austin and Ramsay, above n 529, 1170.

[561] The *Corporations Act 2001* s 95A specifies that:

and payable'. The Australian Securities and Investments Commission (ASIC) lists the early signs that may indicate a company is at risk of insolvency, such as ongoing losses, poor cash flow, absence of a business plan, and creditors remaining unpaid outside the usual terms.[562]

Australian courts and the *Corporation Act 2001* (Cth) apply the cash flow test to establish a corporation's financial status.[563] The *Corporations Act 2001* also provides certain presumptions to indicate insolvency.

For example, s 588E (3)[564] imposes the presumption of insolvency if the company was insolvent at a particular time during the 12 months ending on the relation-back day; it must be presumed that the company was insolvent throughout the period beginning at the time and ending on that day.

Although courts and Australian corporation legislation apply the cash flow test to determine insolvency, Fernandez argues:

> [t]he court will have regard to the commercial realities in considering what resources are available to the company to meet its liabilities as they fall due,

Solvency and insolvency

(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.

(2) A person who is not solvent is insolvent.

[562] Australia Securities & Investments Commission (ASIC), *Information Sheet 42 Insolvency: A Guide for Directors* <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Insolvency_guide_for_directors.pdf/$file/Insolvency_guide_for_directors.pdf>

[563] The definition in s 95A, adopts a cash flow test rather than balance sheet test to determine whether the company is able to pay its debts as they fall due; See also *Cross Interiors Pty Ltd (in liq) v DCT* (2001) 53 NSWLR 213; (2001); NSWSC 621, 54; *Georgiou Building Pty Ltd v Perrinepod Pty Ltd* (2012) 86 ACSR 713; [2012] WASC 72, 39.

[564] The *Corporations Act 2001* s 588E(3) provides that:

If:

(a) the company is being wound up; and

(b) it is proved, or because of subs (4) or (8) it must be presumed, that the company was insolvent at a particular time during the 12 months ending on the relation-back day; it must be presumed that the company was insolvent throughout the period beginning at that time and ending on that day.

> whether resources other than cash are reasonable by sale or borrowing upon security, and when such realisations are achievable.[565]

In other words, to verify the company's financial status using the cash flow test, it is not only physical cash on hand that counts but also the 'proceeds available from debts and facilities that can be drawn upon.'[566]

Two words in the phrase 'incurring a debt', 'debt' and 'incur' will also benefit from explanation. Because the meaning of the word debt is not defined in the law, the term 'debt' is interpreted in various ways and is, at times, difficult to determine.[567] However, considering the purposes of s 588G, the term 'debt' does not include all debts which can be provable in a winding up under s 553.[568] Goldman claims that, according to the purposes of the corporation law, there are two types of debts which can be incurred under s 588G.[569] First, there is a debt incurred at certain times, pursuant to s 588G (1A),[570] concerning financially defined transactions. One such transaction relates to

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[565] Prafula Fernandez, 'Insolvent Trading of Companies' (2002) 4 *Legal Issues in Business* 29, 32. See also See also *Southern Cross Interiors Pty Ltd v Deputy Commissioner of Taxation* [2001] NSWSC 621, [54].

[566] Fernandez, above n 565, 33.

[567] Michael Murray, *Keay's Insolvency: Personal and Corporate Law and Practice* (Thomsom Lawbook Co, 6th ed, 2008) 403.

[568] Robert Baxt AO, *Corporations Legislation 2013* (Thomson Reuters Australia Limited, 2013), 744.

[569] David B Goldman, 'Directors Beware! Creditor Protection from Insolvent Trading' (2005) 23(4) *Company and Securities Law Journal* 216, 218.

[570] The *Corporations Act 2001* s 588G (1A) specifies that:

> For the purposes of this s, if a company takes action set out in column 2 of the following table, it incurs a debt at the time set out in column 3.

When debts are incurred (operative table)		
	Action of company	**When debt is incurred**
1	**Paying a dividend**	**When the dividend is paid or, if the company has a constitution that provides for the declaration of dividends, when the dividend is declared**

uncommercial transactions under s 588FB which holds that directors will have personal liability for debts.[571] Second, a debt incurred under s 588G should not be an actual debt which is incurred day-to-day from the general business operation but it should be a contingent debt.[572] Notwithstanding various interpretations of debt, generally courts' decisions[573] have held that a debt can include a contingent debt.[574]

With regard to the phrase 'incurring a debt', s 588G (1A) provides the presumptions for the time when a debt is incurred. A significant condition for insolvent trading is that there must be a debt incurred. It must be noted that 'debts incurred by a company after it goes into liquidation are not covered by s588G.'[575] In the *ASIC v Edwards* case, Barrett J held that incurring a debt involves any 'act, omission or other circumstance which causes the company to owe the debt.'[576] The determination of a debt incurred under s 588G is not strict but should involve the substance and commercial reality in which the company's liability was exposed.[577] Mandie J explained:

2	**Making a reduction of share capital to which Division 1 of Part 2J.1 applies (other than a reduction that consists only of the cancellation of a share or shares for no consideration)**	**When the reduction takes effect**
3	**Buying back shares (even if the consideration is not a sum certain in money)**	**When the buy- back agreement is entered into**
4	**Redeeming redeemable preference shares that are redeemable at its option**	**When the company exercises the option**
5	**Issuing redeemable preference shares that are redeemable otherwise than at its option**	**When the shares are issued**
6	**Financially assisting a person to acquire shares (or units of shares) in itself or a holding company**	**When the agreement to provide the assistance is entered into or, if there is no agreement when the assistance is provided**
7	**Entering into the uncommercial transaction (within the meaning of s 588FB) other than one that a court orders, or a prescribed agency directs, the company to enter into**	**When the transaction is entered into**

[571] Goldman, above n 569, 218.
[572] Ibid, 218-219.
[573] See also *Shapowloff v Dunn* (1981) 148 CLR 72; *Hawkin v Bank of China* 1992 26 NSWLR 562; and *Hall v Poolman (2007) 215 FLR 243; 65 ACSR 123 (2007) NSWSC 1330*.
[574] See also *Hawkin v Bank of China* 1992 26 NSWLR 562
[575] Austin and Ramsay, above n 529, 1175.
[576] *ASIC v Edwards* (2005) 220 ALR 148; 54 ACSR 583 (2005) NSWSC 831, 81.
[577] *ASIC v Plymin* (2003) 46 ACSR 126, 516.

> The reason for the emphasis upon substance and commercial reality lies in the need to ensure that the language is interpreted, or applied to the fact, in a way which serves the purpose, or fits the context, of a provision aimed at preventing insolvent trading and in a way which avoids absurd results.[578]

Section 588(1A) explains when debt is incurred, but the type of debt, as specified under s 588G, matters. Debts, called deemed debts, are provided for in s 588(1A). These debts will be automatically incurred when there is an action stated under s 588(1A). Another type of debt unfortunately, is not always obvious. For example,

> in relation to contracts for the supply of goods to a company in the future with payment for the goods being required upon delivery or after delivery, some courts have said that the debt is incurred at the time of the order for the goods. Other courts have held that the debt is incurred when the goods are delivered. It depends upon what can be regarded as the substantial act of the company which incurs the debt.[579]

Identification of the actual date when a debt is incurred remains a problematic issue for insolvent trading provisions.

Section 588G (1) states that there must be reasonable grounds for suspecting that the company is insolvent or would become insolvent. In other words, when a company is incurring a debt, there must be reasonable grounds to suspect that the company is insolvent or would become insolvent because of incurring that debt. The *Harmer Report* noted that 'reasonable grounds for suspecting' in the new insolvent trading provisions should require a higher standard of care from company directors.[580]

The test, under s 95A, of reasonable grounds is whether a reasonable person would be concerned about the ability of a company to pay its debts when they become due and payable. The phrase 'reasonable grounds to suspect insolvency' was clarified as an

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[578] Ibid.
[579] James, Ramsay and Siva, above n 378, 5-7.
[580] *Harmer Report*, above n 340, [287].

actual apprehension or fear.[581] The term 'reasonable grounds' should be judged by the reasonable director's standard of ordinary competence.[582] The Australian courts also claimed that the tests to be applied must be both the objective[583] and subjective tests.[584] For instance, Einfeld J in *Metropolitan Fire Systems Pty v Miller*[585] stated that the test is 'one of objectively reasonable grounds which must be judged by the standard appropriate to a director of ordinary competence'.[586] Moreover, Mandie J held in *ASIC v Plymin* that

> What s 588G(2)(a) requires is proof of a subjective awareness by the director of grounds, whether or not the director had a "subjective suspicion" of insolvency, which grounds may be objectively characterised as reasonable grounds for suspecting such insolvency.[587]

In considering the courts' decisions, Murray claims that, for the meaning of reasonable grounds to suspect, the Australian courts depend on the suspicion of insolvency's meaning; there must be more than idle wondering, and 'there must be a positive feeling of actual fear or misgiving amounting to an opinion that is not supported by sufficient evidence.'[588] Anderson and Morrison, however, have a different view, and argue that it is worth nothing that the law requires only suspicion; expectation is not required. Therefore, the threshold is quite low.[589]

Considering the duty to prevent the company from incurring debts in order to prove whether there are reasonable grounds for suspecting that the firm is insolvent or would become insolvent, there are two tests which set out to consider the reasonable grounds for suspecting under s 588G (2):

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581 *Queensland Bacon Pty v Rees* (1996) 115 CLR 266, [303].
582 See *Credit Corp Australia Pty v Atkin* (1999) 30 ACSR 727.
583 *See Powell v Fryer (2001) 37 ACSR 589; (2001) SASC*, 76-77; *Hall v Poolman* (2007) 65 ACSR 123; (2007) NSWSC 1130, 232.
584 See *ASIC v Plymin* (No. 1) (2003) 175 FLR 124.
585 See *Metropolitan Fire Systems Pty v Miller* (1997) 23 ACSR 699.
586 Ibid, 703.
587 *ASIC v Plymin* (No. 1) (2003) 175 FLR 124, 426.
588 Murray, above n 567, 402.
589 Colin J Anderson and David S Morrison, 'Should Directors be Pursued for Insolvent Trading Where a Company has Entered into a Deed of Company Arrangement?' (2005) 13 *Insolvency Law Journal* 163, 166.

- S 588G (2)(a) is an actual awareness which the person at that time should be aware that there are such grounds for suspecting, and
- S588G (2)(b) specifies that the person in that position should be aware regarding the company's situation.

It should be noted that s 588G (2)(a) is a subjective test; in contrast to s 588G (2)(b), which is an objective test.[590]

The final condition of section 588G (1) is whether the debt was incurred at or after the commencement of this Act; that is, at or after 23 June 1993.[591] Thus creditors or liquidators cannot claim a remedy or responsibility of directors for any debts which were incurred regarding insolvent trading before 23 June 1993.

An interesting issue which should be considered under the insolvent trading provisions is the distinction between the statutory duty under s 588G and the common law duty. In other words, if directors breach their duty to prevent insolvent trading according to s 588G, will they also be liable for breaching their fiduciary and common law duties, such as the duty to exercise care and diligence? Several courts have considered this issue. *Morley v Statewide Tobacco Services Ltd*[592] concerned apportioning responsibility for insolvency. Statewide Tobacco Services Ltd originally had two directors, a husband and a wife, who conducted the company business. After the death of the husband, the wife gave all rights to her son to carry on the family business. Under the management of her son, the company continually ran at a loss and was finally pronounced insolvent and in liquidation.

The main creditor sued the wife for allowing the company to trade while it was insolvent and for breaching her duty of care and diligence. However, the wife argued that she left the running of the company to her son and kept herself ignorant. In other words, she claimed that she was a passive or sleeping director who had no involvement

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[590] Della Stanley and Helen Condon, *Piercing the Corporate Veil,* Allen <http://www.allens.com.au/pubs/insol/insolaug00.htm>.

[591] The commencement date of the Corporation Act is 23 June 1993.

[592] *Morley v Statewide Tobacco Services Ltd* (1993) 1 VR 423.

in the operating of the firm. She should not, therefore, have any liabilities to the creditors. Nevertheless, the court held:

> (1) A director cannot say that he had "no reasonable cause" to expect that the company would be unable to pay its debts as they fell due, even though that director was merely a nominal director and sought to take no part in the company's affairs and was thus totally ignorant of the financial position of the company at the relevant time.
>
> (2) A director should not be entitled to hide behind ignorance of the company's affairs which is of his own making or, if not entirely of his own making, has been contributed to by his own failure to make further necessary inquiries. On the other hand, directors are not required to have omniscience. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day to day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information either available to him or which he might with fairness demand from the executives or other employees and agents of the company.

With this reasoning, the director should have kept herself informed regarding the affairs of the company. Thus, the claim concerning being a silent director or ignorance was dismissed. Consequently, she had personal liability to the creditors who suffered from insolvent trading.

A number of other cases confirm that directors, whether executive or non-executive directors, must exercise their duty with reasonable care and diligence, particularly in the case of insolvent trading.[593]

When directors breach their duty to prevent insolvent trading under s 588G, a further question is: Do they also breach a common law duty, such as a duty of care?

On this point, it can be analysed that the duty of care is a duty to protect shareholders and a company. In contrast, the duty to prevent insolvent trading mainly focuses on

[593] See also *Commonwealth Bank of Australia v Friedrich* (1991) 9 ACLC 946; *Permanent Building Society v Wheeler* (1994) 12 ACLC 674; *Daniels v Anderson* (1995) 13 ACLC 614.

creditors' protection. Thus, the duty to prevent insolvent trading is completely separate from the duty of care. Moreover, the duty of care is a common law duty while the duty to prevent insolvent trading is a statutory duty. However, breaching the duty to prevent insolvent trading under s 588G is also likely to have breached the duty of care.

United States

There is no specific law or statute to deal with the insolvent trading problem in the US. Instead, the fiduciary duty theory is applied. The 3rd Circuit Court states clearly that a fiduciary duty of directors is owed not only to the corporation and shareholders but also to creditors.[594] However, the theory of fiduciary duty does not provide for the scope or conditions which directors have to reach,[595] particularly in the case of insolvent trading, and the theory is broadly mentioned by the court. For instance, the 3rd Circuit Court noted that, according to the Pennsylvania law, '[a] director of a non-profit corporation shall stand in a fiduciary relation to a corporation and shall perform his duty as a director'.[596] This statement does not show the conditions which directors have to meet to discharge their fiduciary duty. In other words, the theory of fiduciary duty applied to the insolvent trading case does not provide elementary conditions for execution by company directors.

A fiduciary duty is generally created when both parties enter into a relationship, although some fiduciary duties may arise before or after the clear relationship of the parties.[597] A fiduciary duty is apparent in various ways, such as relating to directors and company agents, partners, trustees, executors and administrators. This duty is referred to in a variety of legislation, for example, corporations law, labour law and criminal law. The fiduciary duty principle is applied similarly to different types of laws, though there are some differences.[598] With regard to the business realm, a fiduciary

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[594] *Lemington*, 659 F 3d 282, 290 (3rd Cir, 2011), 290.

[595] See Stephen M Bainbridge, 'Much Ado about Little-Directors' Fiduciary Duties in the Vicinity of Insolvency' (2006) 1 *Journal of Business & Technology Law* 335, 350.

[596] Ibid.

[597] Frankel, above n 460, 103.

[598] Frankel, above n 461, 795.

duty is a key concept of corporate law which delineates the responsibilities and rights of directors, managers and shareholders.

Rehman claimed that a fiduciary duty can be described, according to the rulings in several cases, in a triad branch of care, good faith and loyalty.[599] However, the Delaware Supreme Court, in 2006, stated that good faith is a subset of loyalty.[600] Thus, the directors' fiduciary duty, under the US concept, is made up of two parts: duty of care and duty of loyalty. However, in the US, a fiduciary duty is imposed widely in relation to the scope for management of company directors. It has no conditions, such as can be found in UK and Australian law, for the insolvent trading case. Therefore, fiduciary duty is applied variously depending on the courts' opinions and the circumstances of each case.

Solvency tests came originally from common law jurisprudence and have been defined and applied inconsistently.[601] The Delaware courts generally apply the cash flow and the balance sheet tests[602] to determine a company's financial status.

Germany

As a civil law country, Germany enacted specific laws to solve the problem of insolvent trading. *GmbHG*, *AktG* and *InsO* provide certain conditions in the case where a corporation has lost up to 50 per cent of its capital share and become illiquid or over-indebted.

The *GmbHG* and *AktG* provide a clear duty to directors according to ss 49 (3)[603] and 92 (1)[604] respectively. A company director has a duty to call for a meeting of

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[599] Mehreen Rehman, *Directors' Duties to Creditors: Mapping the Twilight Zone* (LLM Thesis, The University of Western Ontario, 2012), 109.

[600] *Stone ex rel AmSouth Bancorporation v Ritter*, 911 A 2d 362, (Del Sup Ct 2006), 174 and 310(1).

[601] Rehman, above n 599, 121.

[602] Ibid.

[603] The *Private Limited Companies Act 1892* (Germany) s 49 (3) states: 'A meeting must in particular be convened without undue delay if it is clear from the annual financial statements or the balance sheet prepared in the course of the financial year that half of the share capital has been lost.'

[604] The *German Stock Corporation Act 2010* (Germany) s 92 provides:

(1) If upon preparation of the annual balance sheet or an interim balance sheet it becomes apparent, or if in the exercise of proper judgment it must be assumed that the company has incurred a loss

shareholders if it is clear that the company has lost equal to one half of the registered share capital. The company directors have a special duty provided by the law to inform shareholders and call for a meeting without delay. A director who breaches the duty to give notification of losses may be imprisoned or fined.[605] Moreover, the law also specifies that directors shall conduct a company with care.[606]

The *German Insolvency Statute*[607] states that when a company becomes illiquid or over-indebted, the board of directors or the liquidators must file a request in order to instigate proceedings not later than three weeks after the commencement of insolvency or over-indebtedness.[608] The meanings of insolvency and over-indebtedness are provided in ss 17[609] and 19[610] of the *Insolvency Statute,* respectively. Directors shall

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equal to one half of the share capital, the management board shall promptly call a shareholders' meeting and advise the meeting thereof.

605 The *Private Limited Companies Act 1892* (Germany) s 84 specifies:

'(1) Whoever fails, in their capacity as director, to notify the shareholders of a loss in the amount of half of the share capital shall be liable to imprisonment of no more than three years or a fine.

(2) If the actor acts negligently, he shall be liable to imprisonment for no more than one year or a fine.'

The *German Stock Corporation Act 2010* (Germany) s 401 provides that:

'(1) Whoever, as member of the management board, in violation of § 92 (1) fails to call a shareholders' meeting and to disclose at such meeting a loss equal to or exceeding one-half of the share capital shall be punished by imprisonment of up to three years or by a fine.'

606 The *German Stock Corporation Act 2010* (Germany) s43 and The *Private Limited Companies Act 1892* (Germany) s 93; see Henry P De Vries and Friedrich K Juenger, 'Limited Liability Contract: The GmbH' (1964) 64(5) *Columbia Law Review* 866, 880.

607 The *Insolvency Statute 1994* (Germany) s 15a states:

'(1) Where a legal person becomes illiquid or overindebted, the members of the board of directors or the liquidators shall file a request for the opening of proceedings without culpable delay, at the latest, however, three weeks after the commencement of insolvency or overindebtedness. The same shall apply to the organ representatives of the partners authorized to represent the company or the liquidators in the case of a company without legal personality where none of the general partners is a natural person; this shall not apply if one of the general partners is another company in which a general partner is a natural person.'

608 Brian Cheffins et al, *Comparative Analysis on Legal Regulation of the Liability of Members of the Board of Directors and Executive Organs of Companies,* European Corporate Governance Institute <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1001990>.

609 *The Insolvency Statute 1994* (Germany) s 17 Insolvency provides:

'(1) Insolvency shall be the general reason to open insolvency proceedings.

(2) The debtor shall be deemed illiquid if he is unable to meet his mature obligations to pay. Insolvency shall be presumed as a rule if the debtor has stopped payments.'

610 The *Insolvency Statute 1994* (Germany) s 19, Overindebtedness, specifies:

'(1) Overindebtedness shall also be a reason to open insolvency proceedings for a legal person.

(2) Overindebtedness shall exist if the debtor's assets no longer cover his existing obligations to pay, unless it is highly likely, considering the circumstances, that the enterprise will continue to exist.

compensate the company if any payment was made after the company has become illiquid or after it is deemed to be over-indebted.[611] In addition, as regards a public company, if a company becomes insolvent or over-indebted, the board cannot make any payments, as specified in s 92(2).[612] A director who violates s 92 (2) will be liable for damages.[613]

To stop insolvent trading, there are two significant conditions under German laws: calling for a meeting of shareholders if the company loses up to 50 per cent of capital shares; and filing a formal insolvency proceeding without culpable delay after a corporation has become insolvent. Eidenmüller states that the tests used to verify whether a company is insolvent or over-indebted are carried out on the company's balance sheet and cash flow.[614] When comparing the tests applied in the UK and Germany, however, it is remarkable that a company in Germany will be deemed insolvent earlier than a company in the UK. The reason is that, even though the balance sheet test is applied in the UK, as per insolvency law, UK courts use the cash flow test

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As regards claims in respect of the restitution of shareholder loans or claims deriving from legal transactions corresponding in economic terms to such a loan, for which the creditors and the debtor have agreed, in accordance with s 39 subs (2), that they shall rank lower behind the claims set out in s 39 subs (1), nos. 1 to 5 in the insolvency proceedings, consideration shall not be given to the obligations under the first sentence.

(3) If none of the general partners of a company without legal personality is a natural person, subss (1) and (2) shall apply mutatis mutandis. This shall not apply if the general partners include another company with a natural person as general partner.'

[611] The *Private Limited Companies Act 1892* (Germany) s 64 states: 'The directors shall be obligated to compensate the company for payments made after the company has become illiquid or after it is deemed to be over-indebted. This shall not apply to payments which, after this point in time, are compatible with the due diligence of a prudent businessman. The same obligation shall affect the directors in regard to payments to shareholders if these led to the company becoming illiquid, unless this was not recognisable whilst observing the due diligence referred to in the second sentence. S 43 (3) and (4) shall apply mutatis mutandis to a claim for compensation.'

[612] The *German Stock Corporation Act 2010* (Germany) s 92 specifies:

'(2) If the company becomes insolvent or over-indebted, the management board may not make any payments. The foregoing shall not apply to payments made after this time that are nonetheless compatible with the care of a diligent and conscientious manager. The same obligation shall apply to the managing board for payments to shareholders as far as such payments were bound to lead to the stock corporation's insolvency, unless this was unforeseeable even when employing the care set out § 93 (1) sentence 1.'

[613] The *German Stock Corporation Act 2010* (Germany) s 93 provides:

(3) The members of the management board shall in particular be liable for damages if, contrary to this Act: … 6 payments are made contrary to § 92 (2).

[614] Eidenmüller, above n 470, 250.

to determine financial status of the company. In Germany, both balance sheet and cash flow tests are applied to verify the financial status of the company. Thus, 'a company may be insolvent on a balance sheet test at some point before s214 duty is triggered.'[615]

Table 4.4 summarises the rules implemented by countries to prevent insolvent trading and protect creditors. The table shows there are four essential elements that Thailand needs to consider in reforming its laws: the need for specific provision; the question of a suitable test to verify a company's insolvency; the directors' standard of care; and the issue of the commencement of directors' duty to prevent insolvent trading. Each will now be discussed further, with the last issue explained in Chapter 5.

Table 4.4: Summary of tests to verify company's insolvency and directors' execution for insolvent trading under various jurisdictions

	The United Kingdom	Australia	The United States	Germany
Theory or provision to prevent insolvent trading	Wrongful trading	Insolvent trading	Fiduciary duty	Call for a meeting and initiate insolvency proceeding
Test to verify a company financial status	Balance sheet test (UK Courts also apply cash flow test to cases)	Cash flow test	Balance sheet and cash flow test	Balance sheet and cash flow test
Test to verify directors' duty	Subjective and objective test	Subjective and objective test	-	-

1 The Need for Specific Provisions

As discussed in Chapter 3, the general and specific duties of directors according to the current Thai corporate laws are not efficient to deal with the problem of insolvent trading. There are many legal lacunas affecting a creditors' interest or even the interest of a company. The developed countries reviewed have certain provisions or specific duties in the case of insolvent trading. UNCITRAL also provides legislative guidelines on directors' obligations in the case of insolvent trading, defined in recommendation

615 Davies, above n 37, 320.

255 of the *Guide*.[616] Introducing duties in the case of insolvent trading into Thai corporate law, whether general duties or specific duties, will help maintain justice and protect the interests of relevant parties.

2 Test to Verify a Company's Insolvency

Both cash flow and balance sheet tests are applied in various countries to determine insolvency. As shown in Table 4.4, the US and Germany apply both balance sheet and cash flow tests to verify a company's insolvency, Australia uses only the cash flow test, and the UK uses both, with UK law requiring the use of the balance sheet test but the cash flow test is also being employed by the UK courts.

UK court decisions indicate that the balance sheet test may not be sufficient for determining a company's insolvency, particularly in the current economic climate, because to consider only a company's liabilities, whether it is in excess of or over the value of the company's assets, does not necessarily provide a true reflection of the financial problems. As Davies opined, 'it is further clear that the cash flow test is applied on a commercial reality basis.'[617] If the company is solvent on a cash flow basis, there is no need for creditors to put the company into liquidation.[618] In other words, even if a company is insolvent when applying the balance sheet test, creditors could be paid when the debts are due when the cash flow test is applied. Similarly, Fernandez deemed that the cash flow test is practical for the current world business circumstances because with the cash flow test it is not just physical cash on hand that counts; to verify the company's financial status by a cash flow test would include 'proceeds available from debts and facilities that can be drawn upon.'[619]

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[616] UNCITRAL (2013), above n 492, 13. Recommendation 255 states:

> 'The law relating to insolvency should specify that from the point in time referred to in recommendation 257, the persons specified in accordance with recommendation 258 will have the obligations to have due regard to the interests of creditors and other stakeholders and to take reasonable steps:
>
> (a) To avoid insolvency; and
>
> (b) Where it is unavoidable, to minimize the extent of insolvency.

[617] Davies, above n 37, 319.

[618] Ibid.

[619] Fernandez, above n 565, 33

In contrast, Keay and Murray posited that verifying a company's insolvency for insolvent trading by a cash flow test with respect to the particular time of insolvency is difficult to establish.[620] The reason is that it is hard for a liquidator to claim for insolvent trading by knowing when 'the company is experiencing financial difficulty, and directors have to assess the company's position.'[621] However, Owen J claims that dismissing the balance sheet test would not be correct because the balance sheet can provide 'contextual evidence for the proper application of the cash flow test.'[622] Nevertheless, Keay posits that, although both tests are applied, the cash flow test is generally used as the primary test, and the balance sheet test is employed as a secondary test to assess a company's position.[623]

The UNCITRAL guidelines recommend the use of both the cash flow and balance sheet tests to verify whether a company is insolvent. Recommendation 15 of the *UNCITRAL Legislative Guide on Insolvency Law* provides:

> The insolvency law should specify that insolvency proceedings can be commenced on the application of a debtor if the debtor can show either that;
> a) It is or will be generally unable to pay its debts as they mature; or
> b) Its liabilities exceed the value of its assets.[624]

It is hard to confirm whether either a balance sheet test or cash flow test is better for indicating a company's insolvency. Margret claims that courts around the world employ both the balance sheet and cash flow tests to verify insolvency, except Australian courts which apply only the cash flow test.[625] Employing two tests seems to have advantages. Under the *Bankruptcy Act* in Thailand, the insolvency of a company is verified using the balance sheet test, like in the UK. However, it may be useful for

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[620] Andrew Keay and Michael Murray, 'Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia' (2005) 14(1) *International Insolvency Review* 27, 37.

[621] Ibid.

[622] *The Bell Group Ltd (in liq) v Westpac Banking Corporation* (No9) (2008) 225 FLR1, [1073].

[623] Andrew Keay, 'The Insolvency Factor in the Avoidance of Antecedent Transactions in Corporate Liquidations' (1995) 21 *Monash University Law Review* 305, 311.

[624] UNCITRAL (2005), above n 1, 64.

[625] Julie E Margret, 'Insolvency and Tests of Insolvency: An Analysis of the "Balance Sheet" and "Cashflow" Tests' (2002) 12(27) *Australian accounting review* 59, 60.

the Thai bankruptcy court to consider the factual financial status of a company by using both the balance sheet and cash flow tests, such as courts in the UK, US and Germany do in practice.

3 Directors' Standard of Care

As discussed in Chapter 3, in Thailand, there is uncertainty concerning the standard of care required under Thai laws. The *CCC* and *SEA* state that directors must conduct the company business with the 'diligence of a careful businessman'[626] or an ordinary person undertaking the like business under similar circumstance[627] respectively. The directors' standard meaning in both laws can be interpreted as the standard that would be employed by a reasonable person. However, in the *PLC*, there is no clear standard of care to be examined by directors in discharging their duty. As Ratanakorn suggests, the standard of care for directors under the *PLC* should be the same standard of a careful businessman as identified in the *CCC*.[628] Thus, the standard of care under Thai laws whether the *CCC*, *PLC* or *SEA* should state clearly that directors must conduct a company with the care that a reasonable person would take. This is similar to the rationale in the *Cork Report,* which argued that the standard of directors for wrongful trading is the reasonable man's standard.[629] There are tests to verify whether directors have exercised care.

The UK and Australia apply objective and subjective tests to evaluate a director's performance. Germany does not employ a test but requires that, when the company becomes illiquid or over-indebted, directors file a request for the opening of insolvency proceedings; there is, therefore, no room for directors to use their executive discretion. In this way, German law is stricter than the UK and the Australian laws because directors in these common law countries are still given the opportunity to operate their companies. For example, a director under the Australia jurisdiction can continue to

[626] *CCC,* s 1168.
[627] *SEA* s 89/8.
[628] Ratanakorn, above n 135, 410.
[629] *Cork Report*, above n 305, [1783].

operate his company even if the company is insolvent if a director takes reasonable steps to prevent incurring further debt.[630]

The US courts have not determined whether a fiduciary duty should be applied using either a subjective or an objective test, even though the tests have been applied on a case-by-case basis.

The *UNCITRAL Legislative Guide* does not mention the standard a company director should abide by. It only recommends that a director must take reasonable steps in conducting a company.[631] However, the *Guide* recommends that there should be 'the element to be proved in order to establish a breach of the obligation,'[632] indicating that the view of UNCITRAL is similar to that of Germany and the US, which do not specify subjective and objective tests to verify a director' s management.

Having reviewed the various standards, the author's view is that directors should be assessed through the use of both subjective and objective tests. If directors have more experience, the subjective standard should be applied to their conduct; and the objective test, which refers to a reasonable person, should be the minimum standard of care expected of company directors.[633] Employing both subjective and objective tests can be an incentive for directors to ensure that their management of companies is

[630] The *Corporation Act 2001* (Cth) s 588H (5).

[631] UNCITRAL (2013), above n 492, 13. Recommendation 256 states:

For the purposes of recommendation 255, reasonable steps might include:

(a) Evaluating the current financial situation of the company and ensuring proper accounts are being maintained and that they are up-to-date; being independently informed as to the current and ongoing financial situation of the company; holding regular board meetings to monitor the situation; seeking professional advice, including insolvency or legal advice; holding discussions with auditors; calling a shareholder meeting; modifying management practices to take account of the interests of creditors and other stakeholders; protecting the assets of the company so as to maximize value and avoid loss of key assets; considering the structure and functions of the business to examine viability and reduce expenditure; not committing the company to the types of transaction that might be subject to avoidance unless there is an appropriate business justification; continuing to trade in circumstances where it is appropriate to do so to maximize going concern value; holding negotiations with creditors or commencing other informal procedures, such as voluntary restructuring negotiations;

(b) Commencing or requesting the commencement of formal reorganization or liquidation proceedings.

[632] Ibid, 25. Recommendation 261.

[633] The same as Payne and Prentice mentioned in s 214 (4) of the *Insolvency Act* (UK) that there are two standards imposed. Subsection (a) sets the floor as the objective standard. The ceiling is set in subsection (b) as the subjective standard.

appropriate and efficient. These tests can also be employed to determine directors' liabilities for insolvent trading.

C *Liabilities, Remedies and Defences*

If directors' only have a duty to prevent insolvent trading, they are unlikely to have the incentive to work for the best interests of other stakeholders. To effectively encourage directors not to trade when companies are insolvent, liabilities and defences for punishing and defending directors who do not behave appropriately should also be in place. This part will discuss lifting or piercing the corporate veil and liabilities of directors for breaching the duty to prevent insolvent trading first. Then, the defences will also be clarified.

1 Lifting the Corporate Veil and Directors' Liabilities

As noted in Chapter 3, Thai courts strictly adhere to black letter law. Therefore, lifting or piercing the corporate veil is unlikely to be utilised by the courts unless the law specifically provides direction in this regard. Other countries discussed in this thesis are not shy about doing so, such as in the text of the UK and Australian laws.

If incorporating the lifting of the corporate veil into Thailand's codes and acts stands alone, it may not efficiently reduce the insolvent trading problem. Therefore, the specific insolvent trading provision is needed. It will make a significant difference to court judgements in Thailand. Directors will be liable for insolvent trading and cannot claim the principle of corporate veil to limit their liability. How to reform Thai regulations to achieve a lifting of the corporate veil will be discussed in Chapter 6.

Lifting the corporate veil enables the application of liabilities, particularly personal liabilities, on directors who breach their duty to prevent insolvent trading. In the countries reviewed, both civil and criminal liabilities attach to directors who violate their duties and trade while insolvent.

Under UK law, directors who breach their duty to avoid wrongful trading under s 214 of the *Insolvency Act 1986*, face sanctions as follows:

(1) A director may be liable to make such contribution to the assets of the company by the court's decision;[634] this gives wide discretion to the court to decide on the appropriate sanction. The Cord Committee, remarkably, only recommended civil liability for directors who engage in wrongful trading.[635]

(2) A director may be banned by the court under the *Company Directors Disqualification Act 1986* s 10;[636] and a court can disqualify a director for up to 15 years.

The Australian insolvent trading provisions included in the *Corporations Act 2001* impose both personal civil and criminal liabilities for contravention of the insolvent trading provisions:

(1) Civil liabilities of a director who fails to prevent the company from incurring a debt under s 588G (2). Australian courts can make one or more orders to the director:

- Compensation order: the court may order the director to pay compensation to the company equal to the amount of that loss or damage.[637]
- Pecuniary penalty order: the court may order the director to pay the Commonwealth a pecuniary penalty up to A$200,000 if there was evidence as legislated in s 1317G.[638]

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634 The *Insolvency Act 1986* (UK) s 214 (1) states: Subject to subs (3) below, if in the course of the winding up of a company it appears that subs (2) of this s applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.

635 See Look Chan Ho, 'On Deepening Insolvency and Wrongful Trading' (2005) 20 [August] *Journal of International Banking Law and Regulation* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=741024>.

636 The *Company Directors Disqualification Act 1986* s 10 states: (1) 'Where the court makes a declaration under s 213 or 214 of the Insolvency Act that a person is liable to make a contribution to a company's assets, then, whether or not trading an application for such an order is made by any person, the court may, if it thinks fit, also make a disqualification order against the person to whom the declaration relates.'

(2) The maximum period of disqualification under this section is 15 years.

637 The *Corporations Act 2001* (Cth) s 588J and 1317H.

638 The *Corporations Act 2001* (Cth) s 1317G Pecuniary penalty orders provides that:

A Court may order a person to pay the Commonwealth a pecuniary penalty of up to A$200,000 if:

(a) a declaration of contravention by the person has been made under s 1317E; and

- Disqualification from being the managing director of the company: the director may be disqualified by the court as well as ASIC for the period of time that the courts think is appropriate.[639]

(2) In the case that a director violates s 588G (3), there are criminal liabilities for that director:

- A director may be ordered to pay a criminal penalty up to A$220,000; or
- A director may be imprisoned for up to five years.[640]

Civil and criminal liabilities may attach to a director under German law as well. Where the director fails to file insolvency proceedings within three weeks of being aware of the insolvent state of his company,[641] or if a director makes any payment after a company became illiquid,[642] the director will be personally liable. German law specifies the personal directors' liabilities depending upon the circumstances. For instance, a director who fails to request the opening of insolvency proceedings can be

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(aa) the contravention is of a corporation/scheme civil penalty provision; and
(b) the contravention:
(i) materially prejudices the interests of the corporation or scheme, or its members; or
(ii) materially prejudices the corporation's ability to pay its creditors; or
(iii) is serious.

[639] The *Corporations Act 2001* s 206C Court power of disqualification-contravention of civil penalty provision specifies:
(1) On application by ASIC, the Court may disqualify a person from managing corporations for a period that the Court considers appropriate if:
(a) a declaration is made under:
(i) s 1317E (civil penalty provision) that the person has contravened a corporation/scheme civil penalty provision; or
(ii) s 386- 1 (civil penalty provision) of the Corporations (Aboriginal and Torres Strait Islander) Act 2006 that the person has contravened a civil penalty provision (within the meaning of that Act); and
(b) the Court is satisfied that the disqualification is justified.
(2) In determining whether the disqualification is justified, the Court may have regard to:
(a) the person's conduct in relation to the management, business or property of any corporation; and
(b) any other matters that the Court considers appropriate.
(3) To avoid doubt, the reference in paragraph (2)(a) to a corporation includes a reference to an Aboriginal and Torres Strait Islander corporation.

[640] ASIC, *Duty to Prevent Insolvent Trading: Guide for Directors* <https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg217-29July2010.pdf/$file/rg217-29July2010.pdf>

[641] The *Insolvency Statute 1994* (Germany) s 15a.

[642] The *Private Limited Companies Act 1892* (Germany) s 64.

held criminally liable and punished with imprisonment for up to three years or fined depending on whether the act was intentional or negligent.[643] Where a director makes any payment after the illiquidity of the company, the director must compensate the company for that payment.[644]

There are also personal civil and criminal liabilities for directors of listed companies. There is a civil liability for violating s 92(2) of the *German Stock Corporation Act 2010*.[645] As in the *Private Company Act,* directors must not make any payment after illiquidity. Directors violating this duty will be liable for damages.[646] If the directors or the named management board fail to call a shareholders' meeting when the company has incurred a loss equal to one half of the share capital,[647] criminal liability is applied to those directors, as specified by s 401 (1) of the *German Stock Corporation Act*.[648] German and Australian law, therefore, have similar civil and criminal liabilities to

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[643] The *Insolvency Statute 1994* (Germany) s 15a provides:

> '(4) Whoever, contrary to subs (1), first sentence, also in conjunction with the second sentence or subs (2) or subs (3), does not file a request for the opening of proceedings, does not correctly file a request or does not file a request in good time shall be punished with imprisonment for not more than three years or a fine.
>
> (5) If the perpetrator under subs (4) acts negligently, the punishment shall be imprisonment for not more than one year or a fine.'

[644] The *Private Limited Companies Act 1892* (Germany) s 64 states: 'The directors shall be obligated to compensate the company for payments made after the company has become illiquid or after it is deemed to be over-indebted. This shall not apply to payments which, after this point in time, are compatible with the due diligence of a prudent businessman. The same obligation shall affect the directors in regard to payments to shareholders if these led to the company becoming illiquid, unless this was not recognisable whilst observing the due diligence referred to in the second sentence. S 43 (3) and (4) shall apply mutatis mutandis to a claim for compensation.'

[645] The *German Stock Corporation Act 2010* (Germany) s 92 states: '(2) If the company becomes insolvent or overindebted, the management board may not make any payments. The foregoing shall not apply to payments made after this time that are nonetheless compatible with the care of a diligent and conscientious manager. The same obligation shall apply to the managing board for payments to shareholders as far as such payments were bound to lead to the stock corporation's insolvency, unless this was unforeseeable even when employing the care set out § 93 (1) sentence 1.'

[646] The *German Stock Corporation Act 2010* (Germany) s 93 states:

> (3) The members of the management board shall in particular be liable for damages if, contrary to this Act: …
>
> 6 payments are made contrary to § 92 (2).'

[647] The *German Stock Corporation Act 2010* (Germany) s 92 (1)

[648] The *German Stock Corporation Act 2010* (Germany) s 401 provides: '(1) Whoever, as member of the management board, in violation of § 92 (1) fails to call a shareholders' meeting and to disclose at such meeting a loss equal to or exceeding one-half of the share capital shall be punished by imprisonment of up to three years or by a fine.'

punish directors who breach their duty to prevent insolvent trading, though there is no regulation under German law to disqualify directors.

Directors' liabilities in the US are unclear when compared to the provisions of the countries discussed above. Liabilities of directors who breach their fiduciary duty, in particular in the insolvent trading case, have not been applied consistently. Shu-Acquaye maintains that the theory of fiduciary duty is delineated by the judicial doctrine in some states, whereas 'the statutory formulations replace or supplement the common law' in other states.[649] Nevertheless, when considering the courts' decisions under the US jurisdiction, company directors may be liable for civil and criminal liabilities for breaching fiduciary duties.[650]

Table 4.5 summarises director's liabilities under various jurisdictions.

Table 4.5: Directors' liabilities under various jurisdictions

Country	Liabilities		
The United Kingdom	**Civil**	-	**Disqualify director**
Australia	**Civil**	**Criminal**	**Disqualify director**
Germany	**Civil**	**Criminal**	-
The United States	**Civil**	**Criminal**	-

Liabilities of directors are broadly identified in the UNCITRAL guidelines. Recommendations 259 and 260 of the guidelines state that a company director may be liable if he or she breaches the obligation to prevent insolvent trading. However, the liabilities are limited to 'the extent to which the breach caused loss or damage.'[651] Criminal liability is not considered by the UNCITRAL commission.[652]

As discussed in Chapter 3, there are problems with holding directors liable under Thai corporate laws. One major problem leading to other problems is that Thai corporate

[649] Florence Shu-Acquaye, 'American Corporate Law: Directors' Fiduciary Duties and Liability During Solvency, Insolvency and Bankruptcy in Public Corporations' (2010) 2 *University of Puerto Rico Business Law Journal* 1, 8.

[650] For example, *USSEC v Blackwell*, 291 F. Supp. 2d 673, 687 (SD Ohio 2003): *US v Smith*, 373 F 3d 561, 565 (4th Cir, 2004).

[651] UNCITRAL (2013), above n 492, 24.

[652] *Insolvency Law: Directors' responsibilities and liabilities in insolvency and pre-insolvency cases*, UN GAOR, 40th sess, A/CN 9/WG V/WP 100 (31 October-4 November 2011) 2.

laws do not have a specific provision for duty of directors or liability of directors in the case of insolvent trading. Employing general liabilities of directors leads to unsatisfactory results for creditors, third parties or even the company itself. In other words, general liabilities provided in current Thai corporate laws are inefficient, in particular in the circumstance of insolvent trading. There are legal loopholes for directors to defend themselves and to avoid personal liability. For this reason, it is necessary to implement suitable liabilities for directors to protect the interests of a company, shareholders, creditors and even third parties, and to be a model for Thai regulation reform.

One aim of this thesis is to find a suitable measure to protect creditors' interests. In the author's view, criminal liability has greater influence on directing the behaviour of a director because of the possibility of imprisonment. A pecuniary penalty under civil liability is certainly necessary, so that creditors can obtain compensation for their loss. In regard to a director's disqualification, even though this liability may not significantly affect directors because they can engage in other work unrelated to the work as a director, it can protect society by banning directors from becoming a director for a period of time. Thus, it is likely that the best option is to have civil, criminal and disqualification options simultaneously when attempting to dissuade directors from operating companies while insolvent. What the minimum and maximum directors' liabilities should be will be discussed later in Chapter 6.

2 Remedies

As noted in Chapter 3, there are very few provisions under Thai corporate laws for protecting creditors' interests and the provisions that do exist seem to be resolutions at the end of the process.

Remedies resulting from the failure of company directors to prevent insolvent trading usually go hand-in-hand with the provision of directors' liabilities. If directors are liable for that kind of trading, creditors or the company would have remedies in the form of fines or compensation that directors are required to pay under civil or criminal remedies. The author holds the view that the most important remedy for shareholders

or creditors who suffer as a result of insolvent trading is compensation. Insolvent trading cases are brought when creditors or plaintiffs sue a defendant in order to obtain compensation. The amount of the remedy will depend on the discretion of a court. The UNCITRAL guideline, recommendation 262, states that, if liability is found by a court, the remedies should include 'payment in full to the insolvency estate of any damages assessed by the court.'[653] Minimum and maximum remedies will be discussed further in Chapter 6.

3 Defences

A director will be liable if he or she breaches a duty to prevent insolvent trading whether in common or civil law countries. However, most laws provide defences for the director who operates a company honestly and diligently. Surprisingly, there is no defence available for the director in the German jurisdiction.[654] This means that, in the case of insolvent trading, if a director fails to initiate insolvency proceedings[655] or makes any payment after the company has become insolvent in terms of a private company,[656] there is no exemption of a director's liability. However, in regard to a public company in Germany, there is a defence for the director who makes a payment after the company becomes insolvent if the director does it with a degree of care in a diligent and conscientious manner under s 92(2) of the *German Stock Corporation Act*.[657]

Even though the wrongful trading provision does not limit the particular type of misconduct under UK law,[658] the *Insolvency Act* s 214 (3) provides a defence for a director who may be involved in wrongful trading.[659] The director can claim that he

[653] UNCITRAL (2013), above n 492, 28.
[654] Chantara-opakorn, above n 212, 70.
[655] The *Insolvency Statute 1994* (Germany) s 15a.
[656] The *Private Limited Companies Act 1892* (Germany) s 64.
[657] Brian R Cheffins and Bernard S Black, 'Outside Director Liability Across Countries' (2006) 2006(84) *Texas Law Review* 1385, 1430.
[658] Richard Williams, 'What Can We Expect to Gain from Reforming the Insolvent Trading Remedy?' (2015) 78(1) *The Modern Law Review* 55, 59.
[659] The *Insolvency Act 1986* (UK) s 214 provides: '(3) The court shall not make a declaration under this s with respect to any person if it is satisfied that after the condition specified in subs (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to

took every step with a view to minimising the potential loss to the company's creditors. Hirt contends that it is difficult to make out the defence under s 214(3) because 'the director could not begin to take steps to minimise the loss to creditors until realising that the company was heading for insolvent liquidation.'[660] Moreover, judicial guidance on the requirements in order to establish the defence is not provided. These factors lead to uncertainty in terms of its scope of application.[661] In addition, Keay and Murray suggest that the words 'every step' under s 214(3) is excessively strong. It is almost impossible to prove that every step was taken to minimise loss.[662] Therefore, it can be said that, even though the UK law provides a defence for the director in the case of wrongful trading, the defence cannot be effectively utilised.

Director's defences for insolvent trading under Australian law are spelt out under s 588H (2)-(5):[663]

- Reasonable grounds to expect that a company is solvent;
- Reasonable grounds to believe a reliable person about the information;

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the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.'

[660] Hirt, above n 40, 92.

[661] Ibid.

[662] Keay and Murray, above n 620, 45.

[663] The *Corporations Act 2001* (Cth) s 588H provides that:

(2) It is a defence if it is proved that, at the time when the debt was incurred, the person had reasonable grounds to expect, and did expect, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

(3) Without limiting the generality of subs (2), it is a defence if it is proved that, at the time when the debt was incurred, the person:

(a) had reasonable grounds to believe, and did believe:

(i) that a competent and reliable person (the other person) was responsible for providing to the first-mentioned person adequate information about whether the company was solvent; and

(ii) that the other person was fulfilling that responsibility; and

(b) expected, on the basis of information provided to the first-mentioned person by the other person, that the company was solvent at that time and would remain solvent even if it incurred that debt and any other debts that it incurred at that time.

(4) If the person was a director of the company at the time when the debt was incurred, it is a defence if it is proved that, because of illness or for some other good reason, he or she did not take part at that time in the management of the company.

(5) It is a defence if it is proved that the person took all reasonable steps to prevent the company from incurring the debt.

- Illness or other good reason showing that he or she did not take part in the company management; or
- Reasonable steps taken to prevent the incurred debt.[664]

The director can defend himself by proving only one of these circumstances. It is noticeable that the defence under s 588H (5) is similar to s 214 (3) of the UK law, but the Australian law uses the words 'reasonable steps' instead of 'every step'. The Australian wording is more suitable and practical than 'every step'.[665] However, 'Australian courts have tended to be strict in interpreting the defences available under s 588H, while UK courts have been rather liberal, erring on the side of directors.'[666]

With regard to the defence for the fiduciary principle applied in the US, the business judgement rule is used to evaluate the culpability of directors in the company's affairs. The director's management will be presumed by the business judgement rule to have been executed in good faith, in the best interests of the company and on an informed basis. Hence, the director cannot establish a defence under the fiduciary theory if he or she has not acted in accordance with the business judgement requirement.[667] In the *Lemington* case, the court reasoned that the business judgement rule insulates officers and directors from judicial intervention if they have exercised reasonable diligence and acted honestly in the best interests of the company.[668] Thus, it can be said that the defence for the fiduciary principle will be available only when the director operates the company honestly and diligently.[669]Table 4.6 summarises the above discussion.

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[664] Ramsay, above n 368, 6.

[665] Keay and Murray, above n 620, 46.

[666] Ibid.

[667] Chantara-opakorn, above n 212, 74.

[668] *Lemington*, 659 F 3d 282, 290 (3rd Cir 2011), 291. The court opined that [t]he business judgment rule should insulate officers and directors from judicial intervention in the absence of fraud or self-dealing, if challenged decisions were within the scope of the directors' authority, if they exercised reasonable diligence, and if they honestly and rationally believed their decisions were in the best interests of the company. It is obvious that a court must examine the circumstances surrounding the decisions in order to determine if the conditions warrant application of the business judgment rule.

[669] The court held that '[w]here there is evidence to support a rational conclusion that directors did not exercise reasonable diligence, application of the business judgment rule cannot be decided on a summary judgment motion.'

Recommendation 261 of the UNCITRAL guidelines states broadly that directors can defend themselves if they took reasonable steps in managing a company. This guideline is insufficiently precise to provide a model for reforming Thai law.[670]

Table 4.6: Defences for insolvent trading under various jurisdictions

Country	Defences for Insolvent Trading
Germany	**No defence available for initiating insolvency proceedings (there is a defence for a director only for directors of a listed company who makes any payment after the company has become insolvent with the care of a diligent and conscientious manager – s93)**
Australia	**S 588H** **• Reasonable grounds to expect that the company is solvent;** **• Reasonable grounds to believe a reliable person about the information;** **• Illness or other good reason showing that he or she did not take part in the company management; or** **• Reasonable steps taken to prevent the incurred debt**
The United Kingdom	**S 214 (3)** **'The court shall not make a declaration under this s with respect to any person if it is satisfied that after the condition specified in subs (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.'**
The United States	**The Business Judgment Rule** **'the business judgment rule should insulate officers and directors from judicial intervention in the absence of fraud or self-dealing, if challenged decisions were within the scope of the directors' authority, if they exercised reasonable diligence, and if they honestly and rationally believed their decisions were in the best interests of the company.'**

A detailed comparison of the defences available to directors involved in insolvent trading can be summarised as follows:

[670] UNCITRAL (2013), above n 492, 25. Recommendation 261 states: 'The law relating to insolvency should specify … Those defences may include that the person owing the obligations took reasonable steps of the kind referred to in recommendation 256.'

1. German law, which does not provide any defence for directors who fail to initiate insolvency proceedings, is too strict. It may lead to a poor result if the company still has a chance to carry on its business.
2. Under UK law, the word 'every step' leads to an uncertain outcome. It is difficult to establish a defence under the words 'every step'. There is no guidance on what every step should be, as provided in s 214.[671] Particularly, in practice, directors cannot guarantee that every step of their management will return the company to success.
3. US courts have ruled that the business judgement rule is available if directors have exercised reasonable diligence and acted honestly. There is no exact circumstance to indicate the standard for directors; it depends on the view of a court. However, the business judgement rule is considered to be part of the duty of care. Under the duty of care, directors must work diligently and honestly. This is similar to the claim under the business judgement rule theory. If directors control the company and apply the duty of care, which includes diligence and honesty, they have a shield to protect themselves from insolvent trading under the business judgement rule theory. However, the application of this theory is unlikely to be useful in Thailand, because Thai courts usually strictly adhere to the black letter law. Particularly in the case of insolvent trading, therefore, a precise defence is needed for directors under Thai jurisdiction.
4. Compared to directors' defences of other jurisdictions, the four conditions used under Australian law to defend directors' personal liability from insolvent trading may be suitable for Thailand: the defences are clear and directors may seek a defence under one of four conditions but they must operate the company with care. That is, the duty of care is an important factor in the directors' defence argument.

[671] Cheffins and Black, above n 657, 1418. See also Andrew Keay, 'Directors Negotiating and Contracting in the Wake of Their Companies' Financial Distress' (2015) *Journal of Strategic Contracting and Negotiation* 1, 5. Keay claims that '[t]he steps that directors should take are not articulated in the legislation.'

Thus, although the laws of the other jurisdictions examined provide defences for the problem of insolvent trading, the defences under the Australian law appear to be the most efficient, practical and concrete when compared with the laws of other jurisdictions.

D *Reorganisation*

Company reorganisation is an option to rescue companies from meltdown when they fail to meet all their debts, and also to preserve jobs for employees.[672] A problem under the Thai jurisdiction, which leads to the insolvent trading problem, is the reluctance of Thai organisations to take up the option of reorganisation. The root causes of this reluctance are both legal and cultural, as explained in Chapter 3. The legal cause stems from the fact that the *Bankruptcy Act 1940* requires a minimum amount of debts before the reorganisation option can be taken up. Directors do not have a right to commence reorganisation if the debts of a company do not reach THB10 000 000,[673] even though a company may become insolvent and even though the amount of its debts is less than ten million Baht.

The UNCITRAL, in recommendations 139 and 140, states that insolvency law should provide a reorganisation plan over a period of time.[674] The *Guide* also provides, in recommendations 160 and 161, that a plan for reorganisation be expedited.[675]

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[672] Helen Anderson, 'Theory and Reality in Insolvency Law: Some Contradictions in Australia' (2009) 27(8) *Company and Securities Law Journal* 506, 511.

[673] The *Bankruptcy Act* 1986 (Thailand) s 90/3 - 90/4.

[674] UNCITRAL (2005), above n 1, 234.

Recommendation 139 states:

> The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings or within a specified period of time after commencement of the insolvency proceedings:
>
> (a) The time period should be fixed by the insolvency law;
>
> (b) The court should be authorized to extend the time period in appropriate circumstances.

Recommendation 140 provides:

> The insolvency law should specify that a plan may be proposed on or after the making of an application to commence insolvency proceedings or within a specified period of time after commencement of the insolvency proceedings: where liquidation proceedings are converted to reorganization proceedings, the insolvency law should also address the impact of conversion on time limits for proposal of a plan.

[675] Recommendation 160 specifies:

> 'The insolvency law should specify that expedited proceedings can be commenced on the application of any debtor that:

However, there no minimum amount of debts specified as in the case of the Thai bankruptcy law.

Other jurisdictions examined in this thesis enable directors to file an application to a court for reorganisation or have the obligation to initiate insolvency proceedings when the company is unable to pay its debts, becomes insolvent or is in the pre-insolvency period. Directors can thus avoid trading when the company is or becomes insolvent and the company's business may be saved by restructuring debts to the ultimate benefit of creditors.

The Australian *Corporations Act 2001*, for instance, provides that directors can appoint an administrator if the result of directors' voting shows that the company will become insolvent.[676] This measure is called 'voluntary administration' and is an option for directors to avoid insolvent trading[677] and to secure the company business. Voluntary administration is intended to be a better form of administration for insolvent companies: its procedure is quick to implement, the cost of voluntary administration is cheap, it provides chances for insolvent companies to become solvent companies and

(a) Is or is likely to be generally unable to pay its debts as they mature;
(b) Has negotiated a reorganization plan and had it accepted by each affected class of creditors; and
(c) Satisfies the jurisdictional requirements for commencement of full reorganization proceedings under the insolvency law.'

'Recommendation 161 provides that:
The insolvency law may additionally specify that an expedited proceeding can be commenced on the application of any debtor if:
(a) The debtor's liabilities exceed or are likely to exceed its assets; and
(b) The requirements of recommendation 160, subparagraphs (b) and (c), are satisfied.'

[676] The *Corporations Act* (Cth) *2001* s 436A: a company may appoint an administrator if the board thinks it is or will become insolvent.
'(1) A company may, by writing, appoint an administrator of the company if the board has resolved to the effect that:
(a) in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time; and
(b) an administrator of the company should be appointed.
(2) Subsection (1) does not apply to a company if a person holds an appointment as liquidator, or provisional liquidator, of the company.

[677] Saul Fridman, 'Voluntary Administration: Use and Abuse' (2003) 15(2) *Bond Law Review* 331, 336. However, Fridman argues that there is more possibility that the voluntary administration is abused for relief of directors' responsibility.

so that it gives an advantage to company shareholders and creditors.[678] In the UK, the *Insolvency Act 1986* also provides an option to call in administrators to help directors rescue the company or its business.[679] Directors can file an application to a court for ordering the company's administration.[680] If the court is satisfied that the company is or is likely to become insolvent, the court can order an administration procedure to aid in the survival of the company, realise other advantages of the company, etc.[681]

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[678] Phillip Lipton, Abe Herzberg and Michelle Welsh, *Understanding Company Law* (Thomson Reuters (Professional) Australia Limited, 2016), 836.

[679] Lorraine Conway, *A Comparison: Company Rescue under UK Administration and US Chapter 11* <http://www.parliament.uk/business/publications/research/briefing-papers/SN05527/a-comparison-company-rescue-under-uk-administration-and-us-chapter-11>.

[680] The Insolvency Act *1986* (UK) s 9 Application for order provides:

'(1) An application to the court for an administration order shall be by petition presented either by the company or the directors, or by a creditor or creditors (including any contingent or prospective creditor or creditors), or by all or any of those parties, together or separately.

(2) Where a petition is presented to the court—

(a) notice of the petition shall be given forthwith to any person who has appointed, or is or may be entitled to appoint, an administrative receiver of the company, and to such other persons as may be prescribed, and

(b) the petition shall not be withdrawn except with the leave of the court

(3) Where the court is satisfied that there is an administrative receiver of the company, the court shall dismiss the petition unless it is also satisfied either—

(a) that the person by whom or on whose behalf the receiver was appointed has consented to the making of the order, or

(b) that, if an administration order were made, any security by virtue of which the receiver was appointed would—

(i) be liable to be released or discharged under sections 238 to 240 in Part VI (transactions at an undervalue and preferences),

(ii) be avoided under section 245 in that Part (avoidance of floating charges), or

(iii) be challengeable under section 242 (gratuitous alienations) or 243 (unfair preferences) in that Part, or under any rule of law in Scotland.

(4) Subject to subsection (3), on hearing a petition the court may dismiss it, or adjourn the hearing conditionally or unconditionally, or make an interim order or any other order that it thinks fit.

(5) Without prejudice to the generality of subsection (4), an interim order under that subsection may restrict the exercise of any powers of the directors or of the company (whether by reference to the consent of the court or of a person qualified to act as an insolvency practitioner in relation to the company, or otherwise).'

[681] The *Insolvency Act 1986* (UK) s 8 states:

'(1) Subject to this section, if the court—

(a) is satisfied that a company is or is likely to become unable to pay its debts (within the meaning given to that expression by section 123 of this Act), and

(b) considers that the making of an order under this section would be likely to achieve one or more of the purposes mentioned below, the court may make an administration order in relation to the company.

Chapter 11 of the *Bankruptcy Code* in the US clearly favours debtors to reorganise rather than liquidate.[682] The code provides an option, called a voluntary petition,[683] for directors to reorganise the company when the company is financially troubled.[684] Different to British law, management can continue to run the company pursuant to *Chapter 11*. Under UK law the company must be operated by the administrator. In Germany, the *Insolvency Statue* also delivers a right for directors to initiate insolvency proceedings when a company is facing insolvency.[685]

In summary, the laws of the UK, Australia and the US offer a right to company directors to reorganise when a company is in financial distress. Directors have an

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(2) An administration order is an order directing that, during the period for which the order is in force, the affairs, business and property of the company shall be managed by a person (" the administrator ") appointed for the purpose by the court.

(3) The purposes for whose achievement an administration order may be made are—

(a) the survival of the company, and the whole or any part of its undertaking, as a going concern;

(b) the approval of a voluntary arrangement under Part 1;

(c) the sanctioning under section 425 of the Companies Act of a compromise or arrangement between the company and any such persons as are mentioned in that section; and

(d) a more advantageous realisation of the company's assets than would be effected on a winding up; and the order shall specify the purpose or purposes for which it is made.

(4) An administration order shall not be made in relation to a company after it has gone into liquidation, nor where it is—

(a) an insurance company within the meaning of the Insurance Companies Act 1982, or

(b) a recognised bank or licensed institution within the meaning of the Banking Act 1979, or an institution to which sections 16 and 18 of that Act apply as if it were a licensed institution.'

[682] Robert R Bliss and George G Kaufman, 'US Corporate and Bank Insolvency Regimes: An Economic Comparison and Evaluation' (FRB of Chicago Working Paper, No 2006- 01) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=878355>.

[683] The *Bankruptcy Code Chapter 11* s 1121 provides:

'(a) The debtor may file a plan with a petition commencing a voluntary case, or at any time in a voluntary case or an involuntary case.'

[684] See also Ben Sewell, *Seminar Paper: Challenges to Voluntary Administration For SME Creditors* Sewell and Kettle Lawyers <http://www.sklawyers.com.au/wp-content/uploads/2013/07/22July2013-Seminar-paper-Challenges-to-Voluntary-Administration-for-SME-creditors.pdf?61ef2f>.

[685] The *Insolvency Statue 1994* s 18 Imminent Insolvency provides that:

(1) If the debtor requests the opening of insolvency proceedings, imminent insolvency shall also be a reason to open.

(2) The debtor shall be deemed to be faced with imminent insolvency if he is likely to be unable to meet his existing obligations to pay on the date of their maturity.

(3) If in the case of a legal person, or of a company without legal personality, the request is not filed by all members of the board of directors, all general partners or all liquidators, subsection (1) shall only apply if the person or persons filing the request are empowered to represent the company or the partnership.

option to avoid insolvent trading by applying for an administration procedure,[686] voluntary administration[687] or voluntary petition.[688] In Germany, directors have an option to open insolvency proceedings when a company is in imminent danger of insolvency.

Some scholars believe that insolvency regimes may lead to unsatisfactory results because a company will be brought to liquidation or administration in the early stage of insolvency to avoid a director's personal liabilities,[689] although there is a possibility for the company to trade out of its financial difficulties.[690] However, there is no certainty that directors will avoid liability by opting for voluntary administration.[691] In *ASIC v Plymin* and *Elliott & Harrison*, directors were held liable for insolvent trading even though the directors applied for voluntary administration.[692] Thus, there is no guarantee for company directors even if voluntary administration is applied to secure company business.[693]

In sum, unlike Thailand, none of the examined jurisdictions have a minimum debt floor for the possibility of reorganisation. Hence, the company's debts are considered according to the realistic circumstances of each company. By setting a minimum debt, Thai law does not encourage reorganisation. Thai bankruptcy law should be reformed by deleting minimum debts provision, or by providing a new requirement for reorganisation which considers the company's real financial status. The suggested new provision will be further discussed in Chapter 6.

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[686] See also Chrispas Nyombi, Christopher Gale and Stanley James, 'The Development of Corporate Rescue Laws in Uganda and in UK' (2015) 57(2) *International Journal of Law and Management* 9.

[687] See also Ron W Harmer, 'Comparison of Trends in National Law: The Pacific Rim' (1997) 23 *Brooklyn Journal of International Law* 139, 151.

[688] See also Randal C Picker, 'Voluntary Petitions and the Creditors' Bargain' 1992 61 *University of Cincinnati Law Review* 519, 524.

[689] Keay (2005), above n 44, 445.

[690] James, Ramsay and Siva, above n 378, 10.

[691] Keay (2005), above n 44, 445.

[692] James, Ramsay and Siva, above n 378, 11.

[693] Harris, above n 375, 7.

IV CONCLUSION

As explained above, it can be argued that insolvent trading provisions are important to protect both company and creditors' interests. However, there are some differences in many respects, including how a director is defined, the scope of directors' duties and liability for insolvent trading, and tests to verify a company's insolvency, under various countries and the *UNCITRAL Legislative Guide on Insolvency Law*.

This thesis aims to identify suitable provisions for corporate and insolvency laws reform in Thailand to prevent insolvent trading and protect creditors' interests in that jurisdiction. By conducting a comparative study of the laws of various countries and the *UNCITRAL Legislative Guide*, this chapter has identified a number of primary conditions that should be incorporated in a reform of relevant Thai laws with respect of a precise definition of directors, the scope of directors' duties and liability for insolvent trading, tests for determining a company's insolvency and company reorganisation. However, the advantages and disadvantages of the specific statutory provisions, the fiduciary duty and the legislative guidelines of the UNCITRAL are significant components which need to be considered when aiming to reform Thai law. Therefore, the author points out the strength and weakness of the laws and the guidelines for finding a suitable insolvent trading provisions model for Thailand. Another significant issue is when the directors' duty to prevent insolvent trading starts. This issue will be analysed in detailed in Chapter 5 and Chapter 6. These chapters will discuss and propose insolvent trading provisions for the law in the Thai jurisdiction.

CHAPTER 5: WHEN DOES A DIRECTORS' DUTY ARISE?

I INTRODUCTION

'In popular parlance, "bankruptcy" refers to a state of insolvency.'[694] A significant problem in the Thai jurisdiction is the absence of a director's duty to prevent insolvent trading when a company is in the insolvent state or in the zone of insolvency.[695] For this reason, Thai directors have no liability with respect to insolvent trading. As insolvency can have a significant affect on creditors, directors should have a specific duty to manage company liabilities responsibly. Alternatively, they should be liable for losses caused by their failure in trading while insolvent.

A conflict of interest occurs between shareholders and creditors as a company approaches insolvency, that is, when the company enters the zone of insolvency. Buccola articulates the view of shareholders, advising that, when in the zone of insolvency, a company should continue its operation by employing a bankruptcy relief to restructure its current debt burden. On the other hand, creditors may believe that the company is mismanaged and would prefer firms to begin liquidating assets.[696] Creditors may also believe that company directors should abandon their duty to act in the best interests of shareholders and instead concentrate on their duty to preserve creditors' interests throughout the period in which the company is in the zone of insolvency.[697] Given the conflicts between stakeholders' interests, this period, i.e., the zone of insolvency would benefit from a precise legal statement of what is expected of a director during this period. This is particularly the case in Thailand, where there is no specific duty imposed on directors to prevent them from continuing to trade when their company is insolvent and there are ineffective and adequate liability laws with

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[694] David Ciepley, 'The Corporation is Always Already Government-Supported, and So is Bankruptcy' (2013) 11 *The Georgetown Journal of Law & Public Policy* 349, 352.

[695] The meaning of 'insolvent state' and 'zone of insolvency' are different. When a company is in the insolvent state means that a company is already insolvent, irrespective of whether an application of commencement of insolvency proceedings has been made. However, if a company is in the zone of insolvency, it means that a company is nearing or approaching insolvent but it is not insolvent yet.

[696] Vincent S J Buccola, 'Beyond Insolvency' (2013) 62 *Kansas Law Review* 1, 1.

[697] Gloria Chon, 'Will the Courts Protect the Boards: Defending the Board of a Michigan Corporation in a Zone of Insolvency' (2007) 53 *Wayne Law Review* 1085, 1085.

respect to compensating creditors and shareholders when the company fails. Figure 5.1 illustrates the absence of effective insolvency regulations in Thailand.

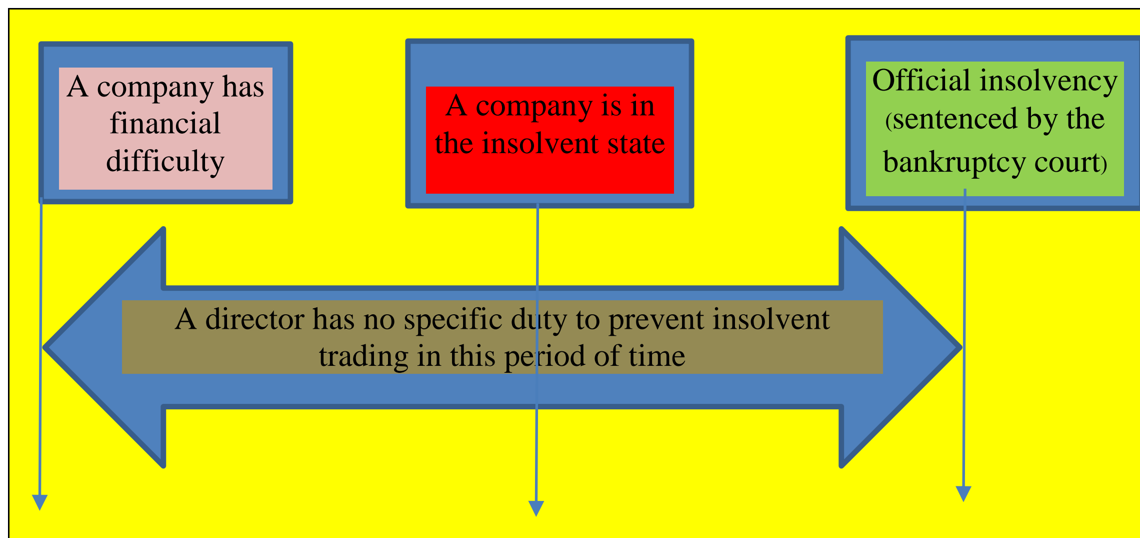

Figure 5.1: Directors' responsibilities during a company's insolvent state in Thailand

In insolvency law, time is of essence in determining when a company is in a state of insolvency. Thus, it is significant to determine when to impose a specific duty on a company director to prevent insolvent trading and impose liability on a director if he or she breaches that duty.

The chapter initially provides a comparative analysis on the point at which insolvency is determined and when specific directors' duties begin. It will then examine the insolvency presumptions under Thai law and compare them with those of other countries to determine whether the current presumptions pursuant to the Thai *Bankruptcy Act 1940* are efficient enough to create a duty for directors in the case of insolvent trading. This examination will be followed by recommendations relating to how to define the time when a duty to prevent insolvent trading in Thai legislation should begin in order to prevent insolvent trading and to identify when a company is in the zone of insolvency or in the insolvent state.

II Commencement of Directors' Duty to Prevent Insolvent Trading as Defined by Other Countries and the UNCITRAL Legislative Guide

A *The United Kingdom*

The *Insolvency Act 1986* (UK), in s 123,[698] provides the following presumptions which allow a court to find a company unable to pay its debts:

(1) A company is indebted for a sum exceeding £750 and neglects to pay the sum for three weeks (s 123 (1) (a)); or

(2) There is a decree or court order which is returned unsatisfied to a creditor (s 123 (1) (b)); or

(3) A company is unable to pay its debts as they fall due (s 123 (1) (e)); or

(4) A court is satisfied with evidence showing that the assets of a company's value are less than the amount of its liabilities. (s 123 (2))

One significant point concerning these insolvency presumptions is that a creditor does not need to prove that a company is insolvent. The creditor simply has to prove that the company is unwilling or unable to pay the particular debt upon a creditor's demand.

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[698] The *Insolvency Act 1986* (UK) s 123 Definition of inability to pay debts provides:

(1) A company is deemed unable to pay its debts—

(a) if a creditor (by assignment or otherwise) to whom the company is indebted in a sum exceeding £750 then due has served on the company, by leaving it at the company's registered office, a written demand (in the prescribed form) requiring the company to pay the sum so due and the company has for 3 weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor, or

(b) if, in England and Wales, execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part, or

(c) if, in Scotland, the induciae of a charge for payment on an extract decree, or an extract registered bond, or an extract registered protest, have expired without payment being made, or

(d) if, in Northern Ireland, a certificate of unenforceability has been granted in respect of a judgment against the company, or

e) if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

(2) A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

(3) The money sum for the time being specified in subsection (1)(a) is subject to increase or reduction by order under section 416 in Part XV.

Proof of insolvency is not required.[699] Moreover, the presumptions, as listed above, can be claimed in accordance with s 123 (1)(e), by applying the cash flow test. Section 123 (2) also employs the balance sheet test to consider a company's liabilities in relation to the value of the company's assets.[700]

However, with regard to wrongful trading, s 214 of the *Insolvency Act 1986* does not employ these presumptions as defined in s 123. As noted below, s 214 states that there is a specific duty on directors to prevent reckless trading or so-called wrongful trading. A company director will be liable for wrongful trading if the company has gone into insolvent liquidation and, at some time before a winding up of the company, a director knew or ought to have concluded that there is no reasonable prospect that the company will avoid insolvent liquidation.[701]

One significant condition under the wrongful trading provision is that a company has gone into 'insolvent liquidation'. The purpose of wrongful trading when a company has gone into insolvent liquidation is found in s 247(2).[702] The meaning of 'insolvent liquidation' is explained by s 214 (6)[703] of the *Insolvency Act 1986* as consisting of three conditions:

(1) a company has gone into liquidation when its assets are insufficient for the payment of its debts, and
(2) a company has gone into liquidation when its assets are insufficient for the payment of other liabilities, and

[699] David Lawler, *Proving Insolvency: a Financial Perspective,* International Corporate Rescue <http://www.chasecambria.com/site/journal/article.php?id=135>.

[700] Simon Hill, *Understanding s239 Preference Under Insolvency Act 1986,* Thomas Bingham Chambers <http://www.tbchambers.co.uk/Legal-Articles/understanding-s239-preference-under-insolvency-act-1986.html>.

[701] The *Insolvency Act 1986* (UK) s 214(2).

[702] Roy Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell Limited, 3rd ed, 2005) 93. *The Insolvency Act 1986* (UK) s 247 (2) states: 'For the purposes of any provision in this Group of Parts, a company goes into liquidation if it passes a resolution for voluntary winding up or an order for its winding up is made by the court at a time when it has not already gone into liquidation by passing such a resolution.'

[703] The *Insolvency Act 1986* (UK) s 214 (6) states: 'For the purposes of this section a company goes into insolvent liquidation if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up.'

(3) a company has gone into liquidation when its assets are insufficient for the expenses of the winding up.

Goode claims that insolvent liquidation according to s 214(6) employs the balance sheet test.[704] Debts and liabilities include prospective and contingent debts,[705] 'but not contingent and prospective assets.'[706] The meaning of debts and liabilities[707] can also be found in the *Insolvency Rule*.[708]

The crucial part under the wrongful trading provision is about the time determined by a liquidator according to section 214 (2)(b). This section states that the liquidator must determine the date on which a director knew or ought to have concluded that there was no reasonable prospect in which insolvent liquidation could be avoided at some time before the commencement of the company's winding up. The purpose of this subsection is clarified in s 214 (4); that a company director, who is a reasonably diligent person having knowledge, skill and experience, ought to know or ascertain that there was no reasonable prospect in which insolvent liquidation could be avoided.

To allege that a company director wrongfully traded, a liquidator must identify a point in time or date at which the director should have known or ascertained that the insolvent liquidation could not be avoided.[709] In other words, the rigid approach is applied to verify the date or time, as shown in *Re Sherborne Associates Ltd*[710] and *Re Continental Assurance Company of London plc*;[711] such a date has traditionally been required by UK judges,[712] but recent rulings have been less rigid. For example, in

[704] Goode, above n 702, 531.
[705] Ibid.
[706] Keay (2007), above n 303, 86.
[707] The *Insolvency Rule 1986* rule 13.12.
[708] The *Insolvency Rule 1986* No 1925.
[709] Rehman, above n 599, 77.
[710] *Re Sherborne Associates Ltd*, [1995] BCC , [42].
[711] *Re Continental Assurance Company of London plc.* (In liquidation) (No.4) [2007] 2 BCLC, [297] and [328].
[712] Thomas Bachner, 'Wrongful Trading Before the English High Court Re Continental Assurance Company of London Plc (Singer v. Beckett)' (2004) 5(1) *European Business Organization Law Review* 195, 197.

Roberts v Frohlich[713] and *Re Kudos Business Solutions Ltd*,[714] the courts were satisfied to accept an estimated date on which the director should have known or ascertained that the insolvent liquidation was not avoidable.

In *Roberts v Frohlich*, for instance, the liquidator pointed out that wrongful trading occurred 'around 1 July 2004 (or alternatively on or around 1 September 2004).'[715] Nevertheless, the court found that the wrongful trading had occurred by 14 September and allowed the liquidator's claim.[716] Similar flexibility was also evident in judgements made in *Re DKG Contractors Ltd*[717] and *Official Receiver v Doshi*.[718]

Given the flexibility of the UK courts, Rehman notes that the specific time at which wrongful trading occurred under the UK court decisions cannot be found.'[719] Rehman also agrees with Keay that 'this concept is inherently elusive'.[720] Mansor claims that wrongful conduct is not required to prove the wrongful trading. The provision requires that 'instead the director's knowledge, or deemed knowledge, needs to be established.'[721] The difficulty for a liquidator is to determine the time when there is no reasonable prospect that the director knew or ought to have concluded that the company can avoid insolvent liquidation at some time before the commencement of the company's winding up. An interesting issue concerning the point of time when liability is incurred relates to what measures or presumptions the UK courts consider at that time.

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[713] *Roberts v Frohlich* (2011) EWHC 257 (Ch) (2011) 2 BCLC 635.

[714] *Re Kudos Business Solutions Ltd* (2011) EWHC 1436 (Ch).

[715] *Roberts v Frohlich* (2011) EWHC 257 (Ch) (2011) 2 BCLC 635, [6].

[716] Andrew Keay, 'Wrongful Trading: Problems And Proposals' (2014) 65(1) *Northern Ireland Legal Quarterly* 63, 69.

[717] *Re DKG Contractors Ltd*, (1990) BCC 903 (Ch D).

[718] *Official Receiver v Doshi*, (2001) 2 BCLC 235 (Ch D).

[719] Rehman, above n 599, 77.

[720] Ibid.

[721] Hariati Mansor, *Solvency, Company Directors' Duties and the Problem of Process and Enforcement: A Comparative Study* (PhD. Thesis, University of Waikato, 2011), 230.

In *Re Produce Marketing Consortium Ltd*,[722] for instance, the court applied s 214 (4) Knox J claimed:

> The knowledge to be imputed in testing whether or not directors knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation is not limited to the documentary material actually available at the given time. This appears from sec. 214(4) which includes a reference to facts which a director of a company ought not only to know but those which he ought to ascertain, a word which does not appear in sec. 214(2)(b). In my judgment this indicates that there is to be included by way of factual information not only what was actually there but what, given reasonable diligence and an appropriate level of general knowledge, skill and experience, was ascertainable.[723]

Thus, according to the judgement of Knox J, to consider s 214 (2) (b), the standards of duty of directors pursuant to subs (4) (a) and (b) will be judged at what is considered to be an appropriate time, meaning that, at some time before the commencement of the company's winding up, there was no reasonable prospect to avoid insolvent liquidation. However, to use both subjective and objective tests of standards of care without any presumptions or indicators is too uncertain for determining the start of directors' liability according to s 214 of the *Insolvency Act 1986*. Overall, the decision regarding when a director' s duty to prevent wrongful trading under the UK law starts has no definite rule and seems to vary depending upon the experiences of directors.

However, it is noteworthy that a duty to prevent wrongful trading arises when a company is in an insolvent state. As Keay explains, 'if a company was not insolvent within the meaning of s 214 (6), no proceedings could be brought.'[724] Therefore, Rehman argues, s 214 is applicable to a company which is already insolvent.[725] Thus, s 214 will be applied only in the case in which a company goes into liquidation at the time when its assets are insufficient or insolvent. A company director has a duty to prevent wrongful trading when a firm is unable to pay its debts and it is not necessary

[722] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.
[723] Ibid [595].
[724] Keay (2007), above n 303, 86.
[725] Rehman, above n 599, 61.

for a company to be officially found insolvent by the court. Therefore, the duty to prevent wrongful trading starts when a firm is insolvent. A company will be established as being insolvent using the balance sheet and cash flow tests, as explained in Chapter 4.

Surprisingly, although the wrongful trading provision was promulgated to provide a remedy of financial compensation as a result of the misconduct of a director,[726] it cannot apply to a company when it is nearing insolvency.[727] Therefore, any trading, that was carried out by the company when it was on the verge of insolvency but not yet insolvent and which was carried out neglectfully or unreasonably, cannot be used against a director and creditors cannot call for any remedy under the wrongful trading provision.

Under the UK jurisdiction, when a company is very close to the state of insolvency, a company director has two options. First, a director has a duty to prevent wrongful trading by taking every step to minimise the potential loss to the company's creditors – the company is allowed to continue trading 'as long as it does not end up in liquidation'.[728] A director who chooses to continue a company's business has to take every step to minimise potential losses to the company's creditors; liabilities for failing to prevent wrongful trading, as explained in Chapter 4, will be established to punish a director if he or she fails to do so.

Second, a director has an option to file an application to a court for ordering the company's administration procedure.[729] However, the UK courts will carefully consider when a director is putting the company into liquidation too early, as such an action will affect the company and creditors. Even though a director can avoid

[726] Williams, above n 658, 55.

[727] This period of time when a company approches insolvency has been variously described as the 'twilight zone', the 'zone of insolvency' or the 'vicinity of insolvency' See *United Nations Commission on the International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law Part four: Directors' Obligations in the Period Approaching Insolvency*' (United Nations Commission 2013), 14 [8].

[728] Mansor, above n 721, 233.

[729] The *Insolvency Act 1986* (UK) s 8-9.

wrongful trading liability by closing the company down and going into early liquidation, there are other grounds on which to criticise the director.[730]

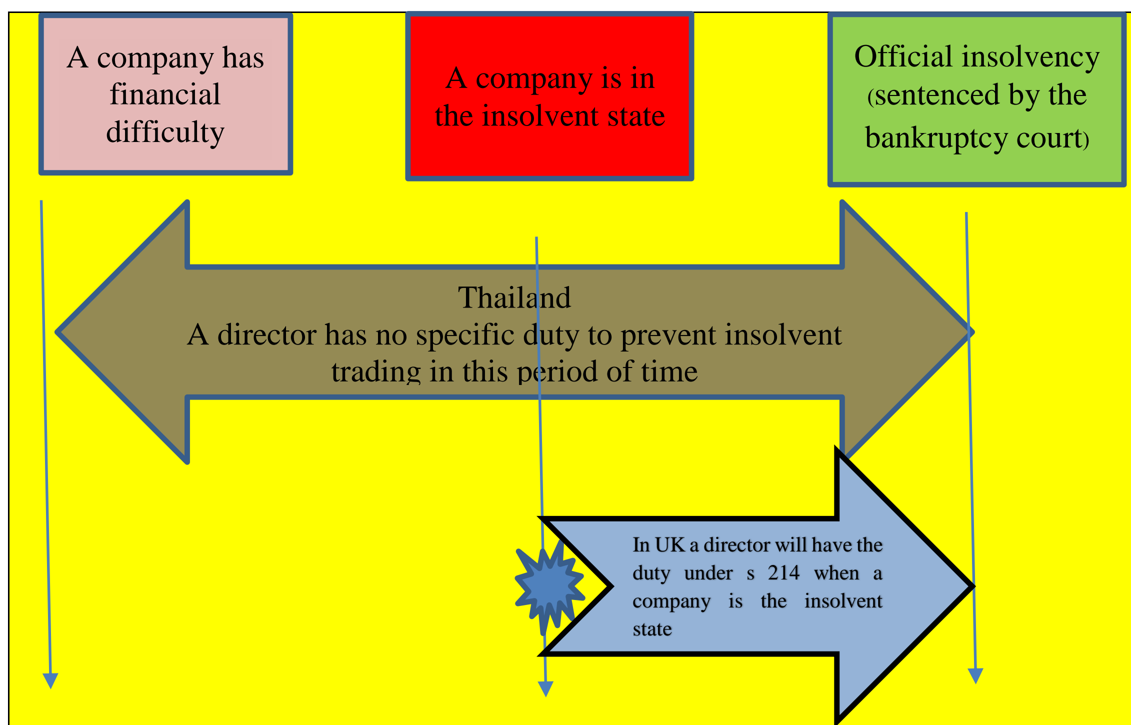

Figure 5.2: Commencement of directors' duty for wrongful trading

B *Australia*

Section 588G of the *Corporations Act 2001* (Cth)[731] is specifically designed to protect creditors by making company directors personally liable for insolvent trading. This

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[730] As Park J pointed out in *Singer v Beckett* (2007) 2 BLBL 287, [281]:

> 'An overall point which needs to be kept in mind throughout is that, whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down and go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma. On the other hand, if they decide to trade on but things do not work out and the company, later rather sooner, goes into liquidation, they may find themselves in the situation of the respondents in this case — being sued for wrongful trading. On the other hand, if the directors decide to close down immediately and cause the company to go into an early liquidation, although they are not at risk of being sued for wrongful trading, they are at risk of being criticised on other grounds. A decision to close down will almost certainly mean that the ensuing liquidation will be an insolvent one. Apart from anything else liquidations are expensive operations, and in addition debtors are commonly obstructive about paying their debts to a company which is in liquidation. Many creditors of the company from a time before the liquidation are likely to find that their debts do not get paid in full. They will complain bitterly that the directors shut down too soon; they will say that the directors ought to have had more courage and kept going. If they had done, so the complaining creditors will say, the company probably would have survived and all of its debts would have been paid. Ceasing to trade and liquidating too soon can be stigmatised as the cowards' way out.'

[731] The *Corporation Act (Cth) 2001* s 588G provides:

(1) This s applies if:

section prescribes four main conditions for a duty of directors to prevent insolvent trading by a company:

- A person is a director when the company incurs a debt
- The company is insolvent or becomes insolvent by incurring a debt
- There are reasonable grounds for suspecting that the company is insolvent or becoming insolvent
- That debt was incurred at or after the commencement of this Act

Details of each condition have already been explained in Chapter 4. However, there are two parts concerning the starting point of a director's duty which should be considered. The wording of incurring a debt according to the second condition and the reasonable ground for suspecting that the company is or would become insolvent pursuant to the third condition.

Regarding the wording of incurring a debt pursuant to the second condition, this can be separated into two main situations required by the law: first, the company incurs a debt, and second, the debt incurred leads to the company becoming insolvent. Therefore, a liquidator or creditors have to be able to prove that the company incurred the debt while it is insolvent or becomes insolvent in incurring that debt.[732] A debt can be created by many business transactions, for example, through loans, mortgages and conveyancing transactions. However, the meaning of debt is not defined in the Act. The guidelines regarding when a debt is said to have incurred by a company is illustrated in s 588G (1A),[733] which lists the many circumstances which can refer to a debt being incurred, and when a debt is incurred.

(a) a person is a director of a company at the time when the company incurs a debt; and
(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and
(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and
(d) that time is at or after the commencement of this Act.

[732] Anil Hargovan, 'Tax Debts and Directors Liability for Insolvent Trading' (2015) 67(5) *Governance Directions* 302, 302.

[733] The *Corporation Act 2001* (Cth) s 588G(1A) states:
For the purposes of this section, if a company takes action set out in column 2 of the following table, it incurs a debt at the time set out in column 3.

Next, consider the reasonable ground for suspecting that the company is or would become insolvent. The meaning of 'company's insolvency', is very important, particularly for insolvent trading provisions, because a company must be insolvent or become insolvent according to a condition specified by the law.[734] The meaning of insolvency can be found in s 95A of the *Corporations Act 2001* (Cth),[735] which provides a broad definition of insolvency as: a company is insolvent if it is unable to pay all its debts 'as and when they are due and payable'. The question whether a company is insolvent of fact, which has to be determined by taking into account of the company's financial position as a whole and the likelihood that the company will have adequate funds avoidable to pay its debts.[736]

When debts are incurred (operative table)		
	Action of company	**When debt is incurred**
1	**Paying a dividend**	**When the dividend is paid or, if the company has a constitution that provides for the declaration of dividends, when the dividend is declared**
2	**Making a reduction of share capital to which Division 1 of Part 2J. 1 applies (other than a reduction that consists only of the cancellation of a share or shares for no consideration)**	**When the reduction takes effect**
3	**Buying back shares (even if the consideration is not a sum certain in money)**	**When the buy-back agreement is entered into**
4	**Redeeming redeemable preference shares that are redeemable at its option**	**When the company exercises the option**
5	**Issuing redeemable preference shares that are redeemable otherwise than at its option**	**When the shares are issued**
6	**Financially assisting a person to acquire shares (or units of shares) in itself or a holding company**	**When the agreement to provide the assistance is entered into or, if there is no agreement when the assistance is provided**
7	**Entering into the uncommercial transaction (within the meaning of s 588FB) other than one that a court orders, or a prescribed agency directs, the company to enter into**	**When the transaction is entered into**

[734] See also David Morrison, 'When is a Company Insolvent?' (2002) 10 *Insolvency Law Journal* 4.

[735] The *Corporation Act 2001* (Cth) s 95A Solvency and insolvency specifies that:

(1) A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable.

(2) A person who is not solvent is insolvent.

[736] *Re Matlic Pty Ltd (in liq)* (2014) NSWSC 1342, [48]-[49].

With this broad meaning of insolvency, the Australian courts face the 'difficulty of interpreting and applying the definition'.[737] In *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)*,[738] Owen J posits that, for determining whether a company is insolvent, an appropriate test should be the cash flow test for assessing solvency.[739] However, dismissing the balance sheet test would not be correct because the balance sheet can provide 'contextual evidence for the proper application of the cash flow test.'[740] However, Morrison claims that the main reasons why the cash flow test should be given priority over the balance sheet test are: (1) the interpretation of s 95A under the *Corporation Act* is deemed to be based on the cash flow test; and (2) the different nature of cash flow and balance sheet tests upon which the mechanisms are based; and (3) the different timing for indicating when a debt was incurred.[741] Nevertheless, Morrison concluded that the balance sheet test is still very useful for determining a company's insolvency.[742]

Moreover, according to the condition providing that there is a reasonable ground to suspect that a company is or would become insolvent at the time of incurring a debt, the insolvent trading provision creates a duty for a director by specifying that if there is a suspicion that a company is insolvent or would become insolvent, company directors have a duty to prevent insolvent trading.[743] This is an important issue which indicates that, under Australian law, when a company is approaching the state of insolvency, directors must beware.

With regard to the period in which directors should suspect their company's insolvency status, the Australian *Corporations Act*, s 588E (3)[744] provides certain presumptions.

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[737] Purslowe, above n 354, 117.

[738] *The Bell Group Ltd (in liq) v Westpac Banking Corporation* (No9) (2008) 225 FLR1.

[739] Ibid, 1072.

[740] Ibid, 1074-1075. Owen J claims: 'The proposition that a balance sheet assessment continues to have some relevance is supported by other authorities … In this litigation, my primary focus is on the cash flow test. But, as will become apparent, it is necessary to look at the balance sheets to resolve some particularly contentious issues.'

[741] Morrison, above n 734, 10.

[742] Ibid.

[743] H H Rajak, 'Director and Officer Liability in the Zone of Insolvency: A Comparative Analysis' (2008) 11(1) *Potchefstroom Electronic Law Journal*, 22.

[744] The *Corporations Act 2001* s 588E provides:

For instance, if a company fails to keep financial records in accordance with subsections 286 (1) and (2), the company is presumed to have been insolvent throughout the period of its non-compliance.[745] In addition, ASIC provides indicators and factors which can indicate to directors that they should suspect their company is insolvent or approaching insolvency. The *Regulatory Guide* published by ASIC,[746] for example, states that if the company has a history of continuing trading losses or the company is holding back cheques for payment or issuing post-dated cheques, directors must consider whether the company is insolvent.[747] Other signs that a company is at risk of

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(3) If:

(a) the company is being wound up; and

(b) it is proved, or because of subsection (4) or (8) it must be presumed, that the company was insolvent at a particular time during the 12 months ending on the relation-back day;

it must be presumed that the company was insolvent throughout the period beginning at that time and ending on that day.

[745] The *Corporations Act 2001* s 588E provides:

(4) Subject to subsections (5) to (7), if it is proved that the company:

(a) has failed to keep financial records in relation to a period as required by subsection 286(1); or

(b) has failed to retain financial records in relation to a period for the 7 years required by subsection 286(2);

the company is to be presumed to have been insolvent throughout the period.

See also *Re Forgione Family Group Pty Ltd (in liq) v Forgione* (2015) FCA 642.

[746] ASIC, *Regulatory Guide 217 Duty to Prevent Insolvent Trading: Guide for Directors* <http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-217-duty-to-prevent-insolvent-trading-guide-for-directors/>.

[747] Ibid. Indicators of potential insolvency

- The company has a history of continuing trading losses.
- The company is experiencing cash flow difficulties.
- The company is experiencing difficulties selling its stock, or collecting debts owed to it.
- Creditors are not being paid on agreed trading terms and/or are either placing the company on cash-on-delivery terms or requiring special payments on existing debts before they will supply further goods and services.
- The company is not paying its Commonwealth and state taxes when due (e.g. pay-as-you-go instalments are outstanding, goods and services tax (GST) is payable, or superannuation guarantee contributions are payable).
- Cheques are being returned dishonoured.
- Legal action is being threatened or has commenced against the company, or judgements are entered against the company, in relation to outstanding debts.
- The company has reached the limits of its funding facilities and is unable to obtain appropriate further finance to fund operations—for example, through:
  - negotiating a new limit with its current financier; or
  - refinancing or raising money from another party.
- The company is unable to produce accurate financial information on a timely basis that shows the company's trading performance and financial position or that can be used to prepare reliable financial forecasts.
- Company directors have resigned, citing concerns about the financial position of the company or its ability to produce accurate financial information on the company's affairs.

insolvency are ongoing losses, poor cash flow, absence of a business plan, and creditors unpaid outside the usual terms.[748] The ASIC list is not intended to be comprehensive. There may be other circumstances or factors which can indicate to directors that a company may be in danger of becoming insolvent.[749]

All the many factors, indicators or presumptions can imply that a company may be insolvent, and they can provide reasonable grounds for suspecting insolvency according to s 588G. It is significant to note that, unlike s 214 of the *Insolvency Act 1986* (UK), s 588G of the *Corporation Act 2001* (Cth) imposes on company directors a duty to prevent insolvent trading even before the company has gone into liquidation since such a duty arises when the company is unable to pay all the company's debts as and when they become due and payable, even before the insolvency proceedings have

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- The company auditor has qualified their audit opinion on the grounds there is uncertainty that the company can continue as a going concern.
- The company has defaulted, or is likely to default, on its agreements with its financier.
- Employees, or the company's bookkeeper, accountant or financial controller, have raised concerns about the company's ability to meet, and continue to meet, its financial obligations.
- It is not certain that there are assets that can be sold in a relatively short period of time to provide funds to help meet debts owed, without affecting the company's ongoing ability to continue to trade profitably.
- The company is holding back cheques for payment or issuing post-dated cheques.

[748] ASIC, *Information Sheet 42*, above n 562: 'Signs that may indicate your company is at risk of insolvency:

- ongoing losses
- poor cash flow
- absence of a business plan
- incomplete financial records or disorganised internal accounting procedures
- lack of cash-flow forecasts and other budgets
- increasing debt (liabilities greater than assets)
- problems selling stock or collecting debts
- unrecoverable loans to associated parties
- creditors unpaid outside usual terms
- solicitors' letters, demands, summonses, judgements or warrants issued against your company
- suppliers placing your company on cash-on-delivery (COD) terms
- issuing post-dated cheques or dishonouring cheques
- special arrangements with selected creditors
- payments to creditors of rounded sums that are not reconcilable to specific invoices
- overdraft limit reached or defaults on loan or interest payments
- problems obtaining finance
- change of bank, lender or increased monitoring/involvement by financier
- inability to raise funds from shareholders
- overdue taxes and superannuation liabilities
- board disputes and director resignations, or loss of management personnel
- increased level of complaints or queries raised with suppliers
- an expectation that the 'next' big job/sale/contract will save the company

[749] ASIC, *Regulatory Guide 217*, above n 746.

commenced. Directors should not have a 'head in the sand' attitude to avoid that their company approaches insolvency.[750] It is obvious that, because of limitless suspicious situations leading to the company's insolvency, directors must be aware of how they carry on a company's business when they come to nearing the insolvent state.

C *The United States*

The US jurisdiction uses a different method for determining insolvency from that used in the UK and Australia. The US courts have not referred to an 'insolvent state', but to 'vicinity of insolvency' or 'zone of insolvency'. A leading case referring to this zone was *Credit Lyonnais Bank Nederland v Pathe Communications Corp* ('*Credit Lyonnais*').[751] Chancellor Allen of the Delaware Court of Chancery discussed the duty of a board of directors where a firm is operating in the vicinity of insolvency.[752] However, he did not provide a precise meaning of the vicinity of insolvency

Nevertheless, Kandestin suggests that the *Credit Lyonnais* case broke new ground by extending 'some sort of insolvency duty beyond insolvency in fact to situations where a corporation labours in the shadow (or vicinity) of insolvency.'[753] Subsequent to the decision regarding the zone of insolvency in *Credit Lyonnais*, the zone has been applied and interpreted by US courts in many cases and in different ways.[754] Kandestin claims that the US courts construe the *Credit Lyonnais* judgement concerning zone of insolvency in three ways: first, some courts have applied the insolvency zone as 'a sword giving creditors the ability to sue';[755] second, some courts have interpreted the zone of insolvency as a time when directors will only breach a duty under the narrow

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[750] ASIC, *Information Sheet 42*, above n 562.

[751] *Credit Lyonnais Bank Nederland v Pathe Comm. Corp.*, No 12150, WL 277613 (Del Ch, 30 Dec 1991) ('*Credit Lyonnais*').

[752] Ibid 34. Chancellor Allen argued that: '[a]t least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise.'

[753] Cory Dean Kandestin, 'Duty to Creditors in Near-Insolvent Firms: Eliminating the Near-Insolvency Distinction' (2007) 60 *Vanderbilt Law Review* 1235, 1250.

[754] See, eg, *Official Comm of Unsecured Creditors v Reliance Capital Group,* (*In re Buckhead Am Corp*), 178 BR 956, 960 (D Del, 1994); *LP v Gordon* (*In re Zale Cor.*), 196 BR 348, 354-55 (Bankr ND Tex 1996); *Pereira v Cogan*, 294 BR 449, 519-20 (SDNY, 2003); *In Production Resources Group, LLC v NCT Group, Inc*, 863 A 2d 772 (Del Ch, 2004).

[755] Kandestin, above n 753, 1250.

definition of a set of circumstances such as fraudulent conveyance;[756] and third, some have applied the zone as a shield to directors[757] as in Vice Chancellor Strine positing that '*Credit Lyonnais* provided a shield to directors from stockholders who claimed that the directors had a duty not to undertake extreme risks so long as the company would not technically breach any legal obligations.'[758]

Consequently, without a clear definition, a company director potentially faces three different obligations: whether a company is solvent, insolvent or on the vicinity of insolvency.[759] Many scholars provide opinions regarding this zone. For example, Peterman and Morissette assert that the zone of insolvency can shift and expand the fiduciary duty of directors when a company is in financial distress.[760] Czaplinski states that the zone of insolvency is an abstraction for expressing a situation where a company is on the verge of insolvency or is likely to become insolvent but it is not yet insolvent.[761] Foreman, Schnabel and Brackett posit that the zone of insolvency is 'when a company is on the brink of becoming insolvent.'[762]

US courts utilise two tests to determine whether a company is insolvent or not:[763] the balance sheet test and the cash flow test (or the so-called the equity test).[764] However, the tests cannot indicate the time when a company is imminently insolvent. Both tests

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[756] Ibid.

[757] Ibid

[758] *In Production Resources Group, LLC v NCT Group, Inc*, 863 A 2d 772 (Del Ch, 2004), 50.

[759] Rutheford B Campbell and Christopher W Frost, 'Managers' Fiduciary Duties in Financially Distressed Corporations: Chaos in Delaware (and Elsewhere)' (2007) 32(3) *Journal of Corporation Law* 492, 504.

[760] Nancy A Peterman and Sherri Morissette, *Directors Duties in the Zone of Insolvency the Quandary of the Nonprofit Corp*. American Bankruptcy Institute <http://www.abi.org/abi-journal/directors-duties-in-the-zone-of-insolvency-the-quandary-of-the-nonprofit-corp>.

[761] Nancy M Czaplinski, *Zone of Insolvency - a Valuation Perspective* American Appraisal <http://www.american-appraisal.com/US/Library/Articles/Zone-of-Insolvency---A-Valuation.htm>.

[762] Michael Foreman, Eric Lopez Schnabel and Jordan Brackett, 'In the Zone: New Insolvency Rules' (2008) 170 *Corporate Board* 19, 19.

[763] Richard M Cieri and Michael J Riela, 'Protecting Directors and Officers of Corporations that are Insolvent or in the Zone or Vicinity of Insolvency: Important Considerations, Practical Solutions' (2004) 2 *DePaul Business & Commercial Law Journal* 295, 307.

[764] Ibid. However, the authors argue that 'It is unclear whether the corporation would have to be found insolvent under both tests in order for fiduciary duties to shift to creditors, or whether the corporation being insolvent under only one test would suffice. There is some support for the proposition that the fiduciary duties of a corporation's directors and officers shift if the corporation is insolvent under either test.'

can only consider whether a company is insolvent or not. In other words, there is no precise test which can be utilised for determining whether a company is in the zone of insolvency.[765] Brent Nicholson posits that the zone of insolvency is presumably 'somewhere or sometime between solvency and insolvency.'[766] The zone of insolvency is as illustrated in Figure 5.3.

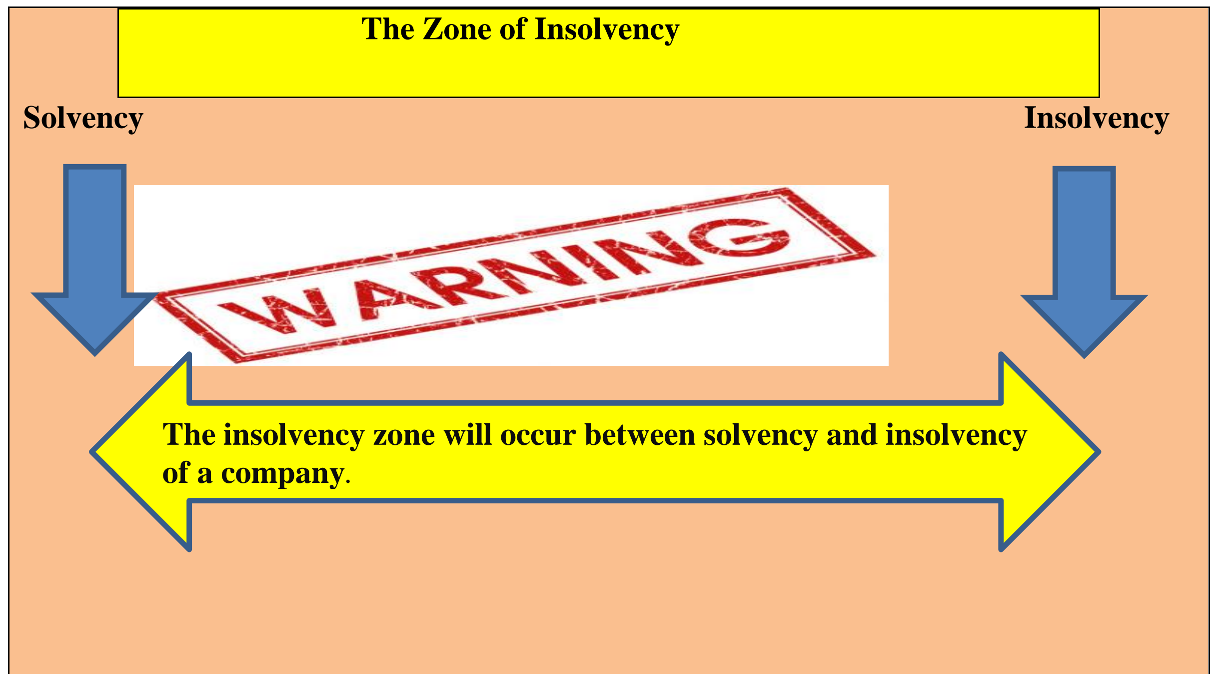

Figure 5.3: Zone of insolvency

But this zone is difficult to define,[767] as pointed out by Vice Chancellor Strine:

> Defining the ''zone'' for these purposes would also not be a simple exercise and talented creditors' lawyers would no doubt press for an expansive view. As our prior case law points out, as discussed above, it is not always easy to determine whether a company even meets the test for solvency ... Given that reality and the plaintiff-friendly standard that applies to attacks on pleadings, it is not surprising that in the past there have been (and inferably in the future there will be) situations when creditors are accorded standing to assert fiduciary duty claims at the

[765] John M Sjovall, 'What Duty Do Company Director Owe to Banks and Other Creditors?' (2004) 121(1) *Banking Law Journal* 4, 13.
[766] Brent Nicholson, 'Recent Delaware Case Law Regarding Director's Duties to Bondholders' (1994) 19 *Delaware Journal of Corporate Law* 573, 588.
[767] Kandestin, above n 753, 1264.

pleading stage and when, after discovery, courts determine that the companies were not insolvent.[768]

The US courts, therefore, have not yet expressed a firm view on whether an insolvency test can determine if a company is in the vicinity of insolvency.[769] In practice, courts may, in hindsight, evaluate whether at a particular point in time a company is insolvent, 'the corporate decision in question was made'.[770] Hence, it is prudent for company directors to evaluate and judge a firm's solvency and to suppose that a firm is in the twilight zone if there is a reasonable question concerning the solvency of the corporation.[771]

Consequently, Cieri and Riela recommend a work plan for directors and officers to verify the solvency of a firm with both the balance sheet and cash flow tests.[772] For example, directors should review the history of the firm's statements or investigate and analyse the corporation's business by assessing the current conditions. Moreover,

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[768] *In Production Resources Group, LLC v NCT Group, Inc*, 863 A 2d 772 (Del Ch, 2004), 56.

[769] James Hm Sprayregen, Pc Theodore L Freedman and Shirley S Cho, *The Zone of Insolvency: When has a Company Entered Into It, and Once There, What are the Board's Duties?* Kirkland & Ellis <http://www.kirkland.com/siteFiles/kirkexp/publications/2529/Document1/Zone%20of%20Insolvency-%20Updated%202002.pdf>.

[770] Cieri and Riela, above n 763, 311.

[771] Richard M Cieri, Lyle G Ganske and Heather Lennox, 'Breaking Up is Hard to Do: Avoiding the Solvency-Related Pitfalls in Spinoff Transactions' (1999) 54(2) *The Business Lawyer* 533, 560.

[772] Cieri and Riela, above n 763, 312-313. 'The following is an example of a work plan that directors and officers can use to determine the solvency of their corporation under both the balance sheet test and the cash flow test:

- review the corporation's historical financial statements (including balance sheets and income statements);
- calculate the applicable financial ratios for the corporation, and compare these ratios to those of competitors;
- review the corporation's business plan projections and assumptions, and compare them to historical performance, the expected performance of competitors, and industry trends;
- investigate and analyze the corporation's business by assessing the current conditions and external competitive factors that will impact its operations and financial performance;
- investigate and analyze current market conditions that would impact the corporation's sources of funding (including equity markets, debt markets, and interest rates);
- test the sensitivity of the corporation's financial projections with respect to revenue variations, margin variations, and interest rate changes;
- determine the corporation's liquidity and free cash flow levels under the projection scenarios;
- perform and evaluate a covenant compliance test for the corporation's funded debt obligations (both drawn and undrawn facilities) under the projection scenarios;
- evaluate the equity cushion available to the company under each of the projection scenarios;
- evaluate the safety margin of the cash flows under each of the projection scenarios;
- investigate and assess the value of the corporation's assets (including intangible assets); and
- investigate and assess the corporation's contingent and off balance sheet liabilities.'

directors should determine liquidity and free cash flow of the company under projection scenarios.[773]

In spite of much deliberation, the conclusions must nevertheless be that currently the zone – whether called vicinity, verge, or zone – of insolvency under the US jurisdiction has not yet been precisely defined. The US courts have resolved problems relating to the zone of insolvency on a case-by-case basis.[774] Also, because of the lack of a clear definition of the zone, directors and officers who find themselves 'in a fuzzy period of heightened uncertainty,' find it difficult to know how to execute their obligations, responsibilities and duties.[775] In other words, 'there are no operational definitions of the beginning and end of a zone of insolvency period.'[776]

In the other two common law countries discussed, the UK and Australia, there is no legal provision for an insolvency zone for wrongful trading; directors have a duty to prevent insolvent trading when a company is insolvent. In the US, directors have a duty to prevent reckless trading when their company is in the vicinity of insolvency, which, unfortunately is not clearly defined.

D *Germany*

The zone of insolvency, with respect to insolvent trading, is not only a difficult concept to define in the US common law jurisdiction, but is also a problem faced in the German civil law jurisdiction. Wood notes that the parameters of the insolvency zone under the German jurisdiction are nebulous and hard to define.[777] However, the threshold of the insolvency zone can be delineated from statements in the *Private Limited Companies Act 1892* (*GmbHG*), the *German Stock Corporation Act 2010* (*AktG*) and the *Insolvency Statute 1994* (*InsO*).

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[773] Ibid.

[774] Anna Manasco Dionne, 'Living on the Edge: Fiduciary Duties, Business Judgment and Expensive Uncertainty in the Zone of Insolvency' (2007) 13 *Stanford Journal of Law, Business & Finance* 188, 188.

[775] John A Pearce and Ilya A Lipin, 'The Duties of Directors and Officers Within the Fuzzy Zone of Insolvency' (2011) 19 *American Bankruptcy Institute Law Review* 361, 368.

[776] Ibid, 378.

[777] Wood, above n 486, 155.

To protect creditors from insolvent trading, s 15a of the *InsO* specifies that, where a firm becomes illiquid or over-indebted, the board of directors shall file for insolvency proceedings without culpable delay.[778] In light of this covenant, German courts and scholars have instituted an explicit approach which gives essential indicators to determine the period of insolvency:[779] illiquidity, impending illiquidity, deficit balance and over-indebtedness.[780] Illiquidity and over-indebtedness are the primary bases for opening insolvency proceedings, while impending illiquidity is an option for debtors to petition the opening of insolvency proceedings.[781]

To clarify the state of insolvency under s 15a of the *InsO*, it is necessary to understand the meaning of illiquidity and over-indebtedness or 'negative equity'.[782] First, the characteristics of illiquidity are provided in s 17 of the *InsO*.[783] A company shall be deemed to be illiquid when it is unable to pay its debts as they fall due. Moreover, illiquidity shall be presumed if a company director has ceased making payments. Therefore, because of the presumption concerning the cessation of paying debts, the German Federal Court has delivered specific circumstances in which a company would be found:

- A director announces the company's inability to pay future obligations

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778 The *Insolvency Statute 1994* (Germany) s 15a Obligation to request in the case of legal persons and associations without legal personality provides:

'(1) Where a legal person becomes illiquid or overindebted, the members of the board of directors or the liquidators shall file a request for the opening of proceedings without culpable delay, at the latest, however, three weeks after the commencement of insolvency or overindebtedness. The same shall apply to the organ representatives of the partners authorized to represent the company or the liquidators in the case of a company without legal personality where none of the general partners is a natural person; this shall not apply if one of the general partners is another company in which a general partner is a natural person.'

779 Bernd Meyer Löwy, *Directors in the Twilight Zone Overview* <http://www.insol.org/congress/pdfs/congresspassword/TAB%204.pdf>.

780 Ibid.

781 Ibid.

782 Katherine Ashton, Vera Losonci and Sarah Cebik, 'When a Multinational Group of Companies is in Financial Difficulty: An Overview of Practical Problems in European Insolvency Proceedings' (2002) 30 *International Business Lawyer* 350, 352.

783 The *Insolvency Statute 1994* (Germany) s 17 specifies:

'(1) Insolvency shall be the general reason to open insolvency proceedings.

(2) The debtor shall be deemed illiquid if he is unable to meet his mature obligations to pay. Insolvency shall be presumed as a rule if the debtor has stopped payments.'

- A company has stopped trading
- A company cannot pay its main operating costs
- There is a writ of Execution against a company[784]

Nevertheless, there are some specific circumstances in which the German courts will not consider that a company is insolvent even though it could not pay its debts or has stopped payments as explained by Halladay and Jark.[785] For example, in a case where a director has a reasonable expectation to believe that the debts can be paid within the next three weeks, the company will not be considered to be illiquid.[786] However, the amount of the debts which the company is unable to pay must be less than 10 per cent of the total payment falling due in that period. If the debts are more than 10 per cent, or are likely to increase, or the shortfall seems unlikely to be paid in the near future, the court will presume that the company is illiquid unless there is a strong reason to believe that the debts will be completely paid.[787]

The main factor for believing that a company is deemed illiquid is limited only to the time when the company stopped payments. Nevertheless, there are many possible circumstances that may cause a company to cease payments for which the German courts have not provided guidelines. Therefore, it can be argued that insolvency under the presumptions of a company's illiquidity is not clearly defined and is uncertain.

Second, the situation where a company is over-indebted is defined in s 19 (2) of the *InsO*.[788] A company is deemed to be over-indebted if its assets no longer cover its

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[784] Löwy, above n 779.

[785] Stephen Halladay and Peter Jark, *Summary of German Insolvency Law*, DLA Piper <https://www.dlapiper.com/~/media/Files/Insights/Publications/2012/05/Summary%20of%20the%20German%20Insolvency%20Law%20Booklet/Files/2_Edition_German_Insolvency_Booklet_May%202012/FileAttachment/2_Edition_German_Insolvency_Booklet_May%202012.PDF>.

[786] Ibid.

[787] Ibid.

[788] The *Insolvency Statute 1994* (Germany) s 19 states:

> '(2) Overindebtedness shall exist if the debtor's assets no longer cover his existing obligations to pay, unless it is highly likely, considering the circumstances, that the enterprise will continue to exist. As regards claims in respect of the restitution of shareholder loans or claims deriving from legal transactions corresponding in economic terms to such a loan, for which the creditors and the debtor have agreed, in accordance with s 39 subs (2), that they shall rank lower behind the claims set out in s 39 subs (1), nos. 1 to 5 in the insolvency proceedings, consideration shall not be given to the obligations under the first sentence.

existing obligations. However, the company will not be deemed over-indebted if a company's directors can show that 'there is a positive continuation prognosis'[789] which leads it to strongly believe that the firm will continue to exist. Weber suggests that the going concern prognosis will be considered by the courts. Therefore, to avoid directors' personal liability from failing to commence insolvency proceedings under s 15a of the *InsO*, the management's prognosis should be determined by an external advisor.[790]

The crucial part in the wording of over-indebtedness under s 19 (2) is that the circumstances in which it can be claimed that the firm will still continue to exist even though it is highly likely to become insolvent, are not clearly scoped or defined. However, Weber argues that as regards over-indebtedness, the strong prognosis in the views of some scholars and recent German case law is that 'the company is able to generate profits in the near future'.[791]

Therefore, there is no certain indicator to determine whether the company is over-indebted. The circumstances will be judged case by case.

This problem regarding the boundary of illiquidity and over-indebtedness affects a director of either a proprietary or a public company governed by the *GmbHG* and *AktG* respectively. According to the *GmbHG*, the director has to compensate for payments made after the company has become illiquid or is deemed to be over-indebted.[792] Similarly, a public company director may not make any payments in the same situation.[793] Failing to do so leads to a director's personal liability.[794] But, as noted above, the circumstance in which the director can assume that the firm is illiquid or over-indebted is unclear.

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[789] Löwy, above n 779.

[790] Lars Weber, *Relaxed Over-Indebtedness Test Extended Permanently* <http://www.gvw.com/aktuelles/newsletter/gvw-international/january-2013/relaxed-over-indebtedness-test-extended-permanently.html>.

[791] Ibid.

[792] The *Private Limited Companies Act 1892* (Germany) s 64.

[793] The *German Stock Corporation Act 2010* (Germany) s 92(2).

[794] Ibid s 93(3).

In determining the duties of directors when a company is in financial difficulty, the *GmbHG* and *AktG* provide a clear definition concerning the duty of directors. According to ss 49 (3)[795]of *GmbHG* and 92 (1) of *AktG*,[796] a company director has a duty to call for a shareholders' meeting if it is clear that the company has lost equal to one half of the registered share capital.[797]

Therefore, it can be concluded that under German corporate and insolvency laws, the directors' duty is defined clearly in the case where up to 50 per cent of the share capital has been lost. Likewise, in a case when the company becomes illiquid or over-indebted, directors also have a specific duty in conducting a company. However, the terms 'illiquid' and 'over-indebted' are vague and unclear.

As detailed in the above context and, in summary:

- In the US, the start of a directors' duty to stakeholders in the case of insolvency insolvent trading is before a company is insolvent, or is in the vicinity of insolvency. However, when this actually occurs is not clearly defined.
- In Germany, in the case of illiquidity or over-indebtedness of a company, the board of directors must file for initiating opening insolvency proceedings without culpable delay (not later than three weeks after the commencement of insolvency or over-indebtedness). Therefore, the starting point of directors' duty in Germany is when a company becomes illiquid or over-indebted.

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[795] The *Private Limited Companies Act 1892* (Germany) s 49(3) provides: 'A meeting must in particular be convened without undue delay if it is clear from the annual financial statements or the balance sheet prepared in the course of the financial year that half of the share capital has been lost.'

[796] The *German Stock Corporation Act 2010* (Germany) s 92(1) provides: 'If upon preparation of the annual balance sheet or an interim balance sheet it becomes apparent, or if in the exercise of proper judgment it must be assumed that the company has incurred a loss equal to one half of the share capital, the management board shall promptly call a shareholders' meeting and advise the meeting thereof.'

[797] The provisions are similar to the Thai *Civil and Commercial Code* s 1172, which specifies:

'The directors may summon extraordinary meeting whenever they think fit.

They must without delay summons such meeting when the company has lost haft the amount of its capital, in order to inform the shareholders of such loss.'

- Under UK and Australian laws, the directors' duty to prevent insolvent trading occurs when a company is insolvent – in the insolvent state – and occurs without the necessity of a court's order.

E *The UNCITRAL Legislative Guidelines*

The period of directors' duty to prevent insolvent trading is mentioned in recommendation 257 of the *UNCITRAL Legislative Guide on Insolvency Law*. The time at which the obligation arises is when a director 'knew or ought reasonably to have known, that insolvency was imminent or unavoidable.'[798] This recommendation is similar to that of the UK law. However, as discussed above, it is difficult to point out the exact time when directors should have been aware that insolvency is unavoidable. The Guide also recommends that when a company is approaching insolvency, directors should still have full power to manage the company, as already discussed in Chapter 4.

Therefore, in all jurisdictions except the US, the directors' duty to a company and creditors begins when a company is in the insolvent state.[799] In the US, the duty begins when the company is in the zone or vicinity of insolvency prior to the state of insolvency; but the zone or vicinity is not clearly defined.

The next section analyses the state of insolvency under the Thai jurisdiction to establish when that jurisdiction considers a director's duty for insolvent trading begins.

III THE STATE OF INSOLVENCY UNDER THE THAI JURISDICTION

The gap in the law in the Thai legislative framework for imposing a duty on company directors to prevent insolvent trading has created a significant problem for company creditors and investors, in particular in the securities market in Thailand. Determining when a company is in a state of insolvency is important when considering the issue of insolvent trading. It is significant to determine when to impose a specific duty on a

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[798] UNCITRAL (2013), above n 492, 16.

[799] See also Carsten Gerner-Beuerle, Philipp Paech and Edmund-Philipp Schuster, *Study on Directors' Duties and Liability* Department of Law, London School of Economics <http://eprints.lse.ac.uk/50438/>.

company director to prevent insolvent trading and impose liability on a director if he or she breaches that duty. However, there is currently no law in the Thai jurisdiction that provides a specific duty on a company director when a company is in the insolvent state. Companies will be recognised as insolvent only when they are judged to be so by the Bankruptcy Court. Without such a judgement, a company is not regarded as an insolvent company even though it is unable to pay its debts. For this reason, it is necessary to impose a specific duty on company directors when a company is in a state of insolvency to prevent insolvent trading in Thai business sectors.

The Thai *Bankruptcy Act* contains nine presumptions for determining that a firm is insolvent.[800] This section will analyse each presumption for suitability in establishing when might be a suitable period for imposing a director's duty. Moreover, all presumptions will be critiqued to determine whether they are appropriate for suggesting insolvent trading provisions. The findings will then be compared with the findings on insolvent trading provisions of other countries to explore when might be an appropriate time to set for establishing when the directors' duty in relation to of insolvent trading should begin in Thailand.

A *Presumptions of Insolvency in Thailand*

Pursuant to the *Thai Bankruptcy Act 1940*, a company is presumed to be insolvent if one or more of the following circumstances occurs:

(a) 'The debtor transfers his property or the right to its management to any other person for the benefit of all of his creditors, whether such act is carried out within or outside the Kingdom.'[801]

This is the first circumstance by which the Thai courts will presume that a company is insolvent. However, to date, no case has been brought to the Thai Supreme Court under this subsection.[802] Mahakhun provides an example of when this circumstance might

[800] The *Bankruptcy Act 1940* s 8.
[801] *The Bankruptcy Act 1940* s 8 (1).
[802] Information based on the search engine provided by the Supreme Court website as of 1 February 2016 <http://www.deka2007.supremecourt.or.th/deka/web/search.jsp>.

occur. A debtor has a company and owes creditors; if the debtor assigns a person, whether he or she is a creditor, to manage the company for the benefit of all his creditors, it will be presumed that the company is insolvent whether the debtor does it within or outside the Kingdom.[803] The significant issue concerns the properties or assets apportioned to pay all creditors. Supanit agrees that transferring property or rights to any person in order to apportion debts for all creditors raises the presumption that a company is unable to pay its debts or it is insolvent.[804] However, transferring property or rights is not within the presumption if it is done for the benefit only of specific creditors.[805]

In my view, this presumption is practical for a small business or single owner, such as for grocery stores or small retail shops, but is not practical in the case of large businesses. For instance, with regard to public companies, directors cannot transfer rights or properties to any person to liquidate all creditors. Directors have duties to comply with all laws, the objects and articles of association of the company as well as the resolution of the shareholders' meetings.[806] Therefore, it is not surprising that there is no claimant bringing a case under this circumstance to the Supreme Court. Consequently, it can be said that the first presumption is limited and not practical for big business.

(b) 'The debtor transfers or delivers his property with fictitious intent or by fraud, whether such act is carried out within or outside the Kingdom.'[807]

Trading with fictitious and fraudulent intent leads to void and voidable acts respectively.[808] However, in regard to an insolvent trading act, fictitious and fraudulent intent are not required. Only negligent trading can cause a director to be liable and responsible for damage to a company and creditors. Hence, this issue will not be

[803] Mahakhun, above n 56, 37.
[804] Supanit, above n 92, 32.
[805] Ibid.
[806] *PLC* s 85.
[807] The *Bankruptcy Act 1940* s 8(2).
[808] *CCC* ss 155 and 159.

explained further because it is not related directly to the duty to prevent insolvent trading as regulated in other jurisdictions discussed in preceding sections of this Chapter.

(c) 'The debtor transfers his property or creates over such property any right in rem which, where the debtor is bankrupt, shall be deemed as favourable, whether such act is carried out within or outside the Kingdom.'[809]

Mahakhun states that this concept is similar to the previous one.[810] Nonetheless, the main point added by the law is that there is a presumption of insolvency in the circumstance of transferring property or creating over such property any right *in rem*[811] shall be deemed as favourable. Any right *in rem* in this concept means legal usufruct, right of habitation, mortgage, etc. Nevertheless, Supanit notes that the difference between this issue and the previous one is that transferring a debtor's property or creating over such property any right *in rem* in this clause will make a difference to only one of all the creditors.[812]

The presumption under (c)[813] is vague. It is difficult to scope a period when a company might be insolvent; this presumption is only an indicator to assume that a company is or should be insolvent at that time.

(d) 'The debtor carries out any of the following acts for the purpose of delaying payment or preventing a creditor from receiving payment of the debt:

a. leaving the Kingdom or having left the Kingdom and remaining outside the Kingdom;

b. leaving the dwelling place where he resided or concealing himself in a dwelling place or absconding by any other means or closing his place of business;

[809] The *Bankruptcy Act 1940* s 8(3).
[810] Mahakhun, above n 56, 38.
[811] Ibid.
[812] Supanit, above n 92, 33.
[813] The *Bankruptcy Act 1940* s 8(3).

c. diverting the property out of the jurisdiction of the Court;

d. allowing himself to be subjected to a judgment compelling payment of money which he ought not to make.'[814]

The Thai Supreme Court has ruled on these circumstances in several cases. For example, the defendants did not have assets for the auction to disburse the creditor. Also, the defendants moved their residence many times without informing the creditors. Under these circumstances, it can be deemed that the defendant is insolvent.[815]

In the circumstance where the defendant closed his business for the reason of delaying payment or preventing the creditor from obtaining payment of the debt, this can also be deemed as a defendant being insolvent according to the *Bankruptcy Act 1940* s8 (4) (b).[816] Furthermore, the defendant's flight from a warrant of arrest in a criminal case regarding a bounced cheque is grounds in which a court can assume that a defendant is insolvent.[817]

Any one of these events can be an indicator that a company is insolvent. The presumptions appear to be similar to the indicators as provided by ASIC referred to above. However, a significant difference is the timing. ASIC's indicators list the many signs where company directors should be aware of when a company is at risk of insolvency. In contrast, the presumptions under Thai law only apply when a company is deemed to be insolvent. This means that a company will not be assumed to be insolvent even if it has the potential to become insolvent.

(e) 'The debtor is subject to seizure of property under a writ of execution or has no property susceptible of seizure for payment of the debt.'[818]

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[814] The *Bankruptcy Act 1940* s 8(4).
[815] Thai Supreme Court case no 2689/2535.
[816] Thai Supreme Court case no 7454/2548.
[817] Thai Supreme Court case no 159/2519.
[818] The *Bankruptcy Act 1940* s 8(5).

The Thai Supreme Court has made several judgements of the same kind regarding this presumption in many cases. For example, in the case 1866/2548, the Court ruled that, according to evidence, the defendants owed the plaintiff the amount of THB5 495 094.53. The defendants had only three pieces of land which were mortgaged to other creditors. Moreover, there was no evidence showing that the defendants' assets had a value of more than the debts to pay the plaintiff. Also, the defendant did not attempt to find money for discharging his debt to the plaintiff. In these circumstances, the Court held that there was no reason to argue that the defendant was not insolvent.

The Supreme Court also ruled that the defendant was assumed to be insolvent according to s 8 (5) of the *Bankruptcy Act 1940* when a defendant had no more assets and did not have his name on a title deed which should have been a guaranteed asset for paying back the plaintiff[819] or assets of the defendant were seized under a writ of execution[820] or no defendant's assets were available for seizure and liquidity to the plaintiff.[821] However, the problem of this presumption is that it applies only once the company is insolvent.

(f) 'The debtor makes to the Court a declaration, in any action, of his inability to pay the debt.'[822]

In this event it is obvious that a debtor or defendant is unable to pay the debt. Therefore, courts can easily presume that the debtor is insolvent.

(g) 'The debtor makes a notification to any of his creditors of his inability to pay the debt.'[823]

For instance, in Supreme Court case no 2203/2531, the Plaintiff claimed that the cheque ordered by the defendant was refused by the bank and the plaintiff had asked the defendant for the payment many times. The defendant ignored these requests and

[819] Thai Supreme Court case no 2867/2544.
[820] Thai Supreme Court case no 887/2535.
[821] Thai Supreme Court case no 2557/2532.
[822] The *Bankruptcy Act 1940* s 8(6).
[823] The *Bankruptcy Act 1940* s 8(7).

also advised that he was unable to pay the debt. The Thai Supreme Court ruled that the defendant was insolvent and the plaintiff's accusation was justified.

This presumption may be a good indicator for showing when a company or debtor is insolvent. By advising of its inability to pay the debt, it is clear that a company has financial problems and is possibly near insolvency or already insolvent.

(h) 'The debtor makes a debt composition proposal to at least two creditors.'[824]

The debt composition proposal is a case where a debtor makes an agreement with the creditors to liquidate some amount of debt and it leads to an extinction of the obligation. For example, the debtor owes the creditor an amount of THB500 000. The debtor makes a debt composition proposal to the creditor for the amount of THB200 000, which, when paid, extinguishes the debt.[825] Making a debt composition proposal to at least two creditors can also show that the debtor's assets are not sufficient to pay the debts.[826] In other words, the debtor is unable to pay the debts or is insolvent.

(i) 'The debtor has received from the creditor a letter of demand at least twice with an interval of not less than thirty days and the debtor has failed to make payment of the debt.'[827]

There are a number of cases where courts have ruled that a defendant is presumed insolvent according to sub section (i).[828] This presumption can be an indicator that a company is insolvent or nearing insolvency. This presumption provides for a period when a debtor can be deemed insolvent: at least 30 days with notification twice and the debtor's failing to make a payment.

However, all presumptions provided in the *Bankruptcy Act 1940* are only guidelines for the Thai courts to consider insolvency cases. If there are other circumstances

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[824] The *Bankruptcy Act 1940* s 8(8).
[825] Supanit, above n 92, 36.
[826] Thai Supreme Court case no 7602/2553.
[827] The *Bankruptcy Act 1940* s 8(9).
[828] Thai Supreme Court case nos: 938/2530, 849/2535, 7994/2553.

showing that a debtor is unable to pay the debt, the courts can also presume that a debtor is insolvent.[829]

Any one of the insolvency presumptions under Thai *Bankruptcy Act 1940* can be used when a company is sued as an insolvent company. However, when a company is in an insolvent state before an accusation of insolvency is brought, the insolvency presumptions are not utilised for the case of insolvent trading. Thus, there is an urgent need for the capacity of the court to apply the insolvency presumptions to help indicate a company's state of insolvency by imposing a duty on directors when a company is in the state of insolvency in order to prevent insolvent trading. In other words, the term insolvent state should be provided for in the *Bankruptcy Act 1940*.

B *Commencement of Directors' Duty to Prevent Insolvent Trading*

Protecting creditors' interests is an important issue, particularly in the case of insolvent trading and company directors should have a duty not to engage in insolvent trading. As already noted, each jurisdiction examined for this thesis and the UNCITRAL guidelines has defined the starting point of the duty using different perspectives. This section will first, compare these starting times then offer suggestions for how Thailand might identify the time when a duty attaches to a director not to engage in insolvent trading.

1 Comparing Starting Times

Figure 5.4 summaries the starting times for when duties commence for directors with regard to prevent insolvent trading.

[829] Thai Supreme Court case no 291/2485.

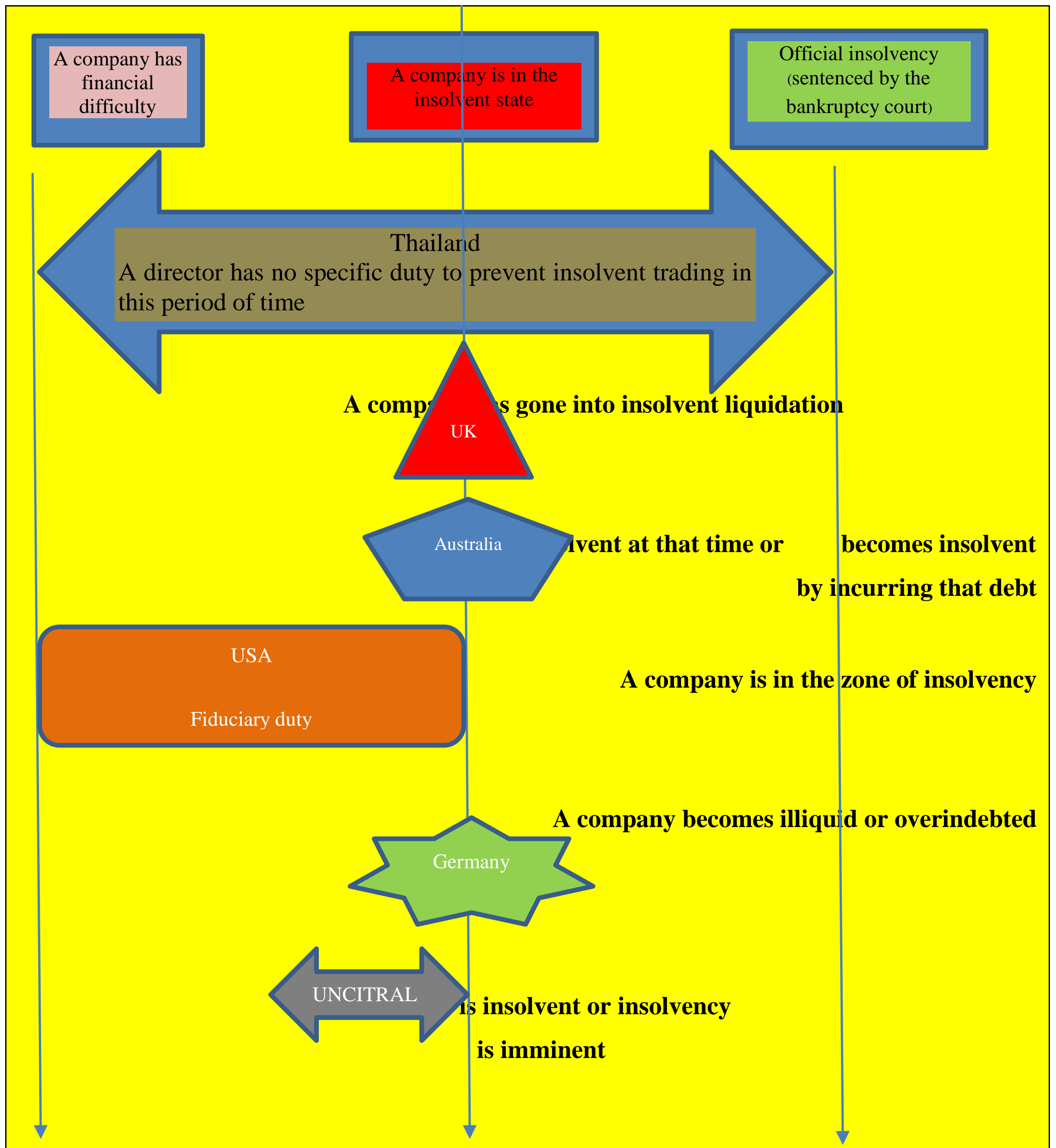

Figure 5.4: Comparing the starting point of directors' duty for preventing insolvent trading under various jurisdictions

In all jurisdictions except the US, the commencement of a director's duty to prevent insolvent trading is when a company is in the insolvent state. The *UNCITRAL Legislative Guide* separates this time into two periods: the commencement of a director's duty when a company becomes insolvent, as is the case in the UK, Australian and Germany; commencement of the director's duty when insolvency is imminent or

unavoidable, which is similar to the US concept.[830] It is noteworthy that a company is insolvent under the UK, Australian and German laws without having to have a court order, unlike Thailand in which companies need an order from the Bankruptcy Court to be recognised as insolvent.

With respect to presumptions and indicators, in Australia, the *Corporations Act* s 588E states that if a company is being wound up and it is proved that within twelve months before the winding up the company was insolvent, it can be presumed that the company was insolvent throughout that period of time.[831] In addition, if the company fails to keep or retain financial records pursuant to s 286(1) and (2), the period of time in which it is presumed that the company was insolvent is up to seven years.[832] Ramsay argues that it is hard to prove that a company was insolvent if the financial records were not kept or retained.[833] Therefore, these presumptions are useful for determining whether insolvent trading was carried out because it requires reasonable grounds to suspect that a company is insolvent.[834] In other words, failure to keep financial records makes it easier for a liquidator to establish an insolvent trading case.[835]

Under the *Insolvency Statute* of Germany, even though the law apparently provides a directors' duty in the case of insolvent trading, the legal contexts are not clearly defined as already explained above. For example, the meaning of insolvency under the *InsO* s17 is limited only to the time when the company has stopped paying its debts. Also, the meaning of over-indebtedness is not properly scoped out. There are many circumstances which directors can use as a defence to claim that a company is not over-indebted. Hence, the courts decisions will vary depending on the circumstances put before them.

[830] See Recommendation 257 of UNCITRAL disscussed above.
[831] The *Corporation Act 2001* (Cth) s 588E (3).
[832] The *Corporation Act 2001* (Cth) s 588E (4).
[833] Ramsay, above n 368, 5.
[834] Ibid.
[835] Christopher Symes, David Brown and Mark Wellard, *Australian Insolvency Law Cases and Materials* (LexisNexis, Butterworths, 2016), 619.

Also, as discussed, ASIC has published a list of indicators of insolvency.[836] For example, if the company has a history of continued trading losses or the company is holding back cheques for payment or issuing post-dated cheques, directors should consider whether the company is still solvent. Therefore, to avoid responsibilities or liabilities from insolvent trading, directors have to continuously monitor the company's financial status to ensure there are no signs that the company is approaching insolvency. The circumstances listed by ASIC are, however, not intended to cover all indicators of insolvency.

Indicators to be used by German Courts have only a few relevant circumstances. They are provided for the main purpose of showing that a company has stopped payment according to the presumption of insolvency under s17 of the *InsO*. Thus the indicators used in the Australian jurisdiction are broader than those used in Germany. Even though the Australian indicators are broad, they are not detailed by courts, providing only circumstances of which directors must be aware.

With these observations in mind, it can be concluded that to create the directors' duty for insolvent trading under the Thai jurisdiction, it is necessary first to consider when a duty to prevent insolvent trading should start. The term "insolvent state" should be provided for in the *Bankruptcy Act 1940*. Second, the presumptions and indicators can be used to clarify the insolvent trading provisions. Also the relevant Thai state agency should provide guidelines to company directors to make them more aware of when a company may be insolvent.

Next, presumptions and indicators will be analysed to indicate when a duty of care should start for directors in relation to insolvent trading under the Thai jurisdiction.

2 Resolution of the Starting Point of Directors' Duty for Insolvent Trading Under Thai Jurisdiction

Thai law does not recognise the insolvent state in which a director should manage the company with great care in order to prevent insolvent trading. To create the directors'

[836] ASIC, *Regulatory Guide 217*, above n 746.

duty, the issue of whether the current presumptions under the Thai *Bankruptcy Act 1940* can be utilised for creating a time at which a duty attaches to a director not to engage in insolvent trading should first be examined. Then the question of when is the most appropriate time to impose a duty on directors in Thailand should be answered.

As noted, Thai courts use nine circumstances to determine if a company is insolvent, and there is reasonable evidence or circumstances to show that the company is unable to pay its debts, and the company can be deemed by the courts to be insolvent.

These presumptions can be utilised as indicators for verifying a company's insolvency. However, at present, the presumptions are not applied when a company is in the insolvent state. In other words, none of the presumptions can determine when a director should be given a duty not to engage in insolvent trading.

When is the most appropriate time to impose the duty on a director in Thailand? The experience and the laws of various countries and the UNCITRAL can provide guidance to establish the commencement a director's duty for the Thai jurisdiction. According to the research of this thesis, the starting point of a director's duty as recognised by various countries and the UNCITRAL, except the US, is when a company is actually insolvent. In other words, directors' duty to prevent insolvent trading should arise when a firm is actually insolvent or in the insolvent state even before the commencement of insolvency proceedings. As regards the zone of insolvency, it is difficult to determine the exact time when a company is approaching insolvency as it has occurred in the US. Hence, the director's duty to prevent insolvent trading when a company is in the zone of insolvency is not recommended as it is still not precisely defined. Therefore, a company director in the Thai jurisdiction should have a duty to prevent insolvent trading when a company is actually insolvent or called in the insolvent state.

Thus, the *Thai Bankruptcy Act 1940* should recognise the insolvent state and impose a duty on directors when a company is in this state. Following the lead of other jurisdictions examined in this thesis, the starting point of a director's duty to prevent

insolvent trading is when a company is in the insolvent state or unable to pay its debts according to balance sheet and cash flow tests.

Also following the lead of other jurisdictions, notably ASIC's indicators and Germany's circumstances, this thesis suggests that Thai government departments, particularly the Securities and Exchange Commission (SEC), should provide indicators that will help companies to determine when they are approaching insolvency. This will be a useful instrument to protect directors and prevent creditors from insolvent trading.

Therefore, the resolution concerning the starting point of a director's duty to prevent insolvent trading under the Thai jurisdiction should be considered in two ways. First, the state of insolvency and a specific directors' duty should be provided in the *Bankruptcy Act 1940*. The law should impose a duty on directors when a company is in the insolvent state. Next, the SEC or other related government departments should determine a number of events or circumstances which can indicate that a company is nearing insolvency. The indicators should specify that, when a company is close to insolvency, directors shall be aware and have a special duty not to engage in insolvent trading. A recommendation for a model concerning insolvent trading provisions will be provided in the Chapter 6.

III CONCLUSION

It is not surprising that current Thai legislation is incapable of preventing insolvent trading by company directors. A significant problem is that the current laws, whether the *CCC*, *PLC*, *SEA* or the *Bankruptcy Act 1940*, do not focus on the period called 'the insolvent state'. Under Thai laws, a company director can generally operate a firm even if it is actually insolvent. Without a court order, a company will not be considered an insolvent company even though it is unable to pay to debts.

Thus, timing is one significant factor which needs to be focused on in reforming Thai insolvency law. The duty of a director to prevent insolvent trading should arise when a company is in the insolvent state. For Thailand, it is necessary to take the state of insolvency into account, in order to prevent insolvent trading. To reform Thai law, the

insolvent state needs to be incorporated into the insolvency laws, as does a provision concerning the commencement of a directors' duty not to engage in insolvent trading. In other words, Thai bankruptcy law should impose a duty on directors not to engage in insolvent trading when a company is actually insolvent or in the state of insolvency.

Listing indicators of insolvency can provide good support to insolvent trading provisions. These indicators will enable directors to increase their awareness of when a company is nearing insolvency. Therefore, the Thai SEC should provide guidelines for directors and creditors to increase their awareness of the company's financial situation, particularly when the company is approaching insolvency.

In sum, Thai law needs to be reformed in two ways. First, the term 'insolvent state' should be provided for in Thai legislation and the legislation should clarify that a director's duty not to engage in insolvent trading starts when a company is in the insolvent state or is actually insolvent without a court's order. Second, the SEC should provide guidelines to help increase the awareness of directors and creditors concerning insolvency.

CHAPTER 6: REFORMING THAI REGULATION

I INTRODUCTION

Trading during a corporate collapse is a significant problem at both the domestic and international levels. Developed countries such as the UK, Australia, the US and Germany, have specific legislative provisions or a fiduciary duty theory to deal with this problem.[837] For instance, the UK *Insolvency Act 1986* has a wrongful trading provision to deal with the problem of reckless trading while a company is insolvent. Similarly, the Australian *Corporations Act 2001* has insolvent trading provisions imposing a duty on directors to prevent such activities. Likewise, German corporate law has a specific directors' duty for when a company is over-indebted or becomes illiquid. And the theory of fiduciary duty is utilised in the US jurisdiction to deal with the problem of insolvent trading.

At the international level, UNCITRAL has examined instances of trading while an enterprise faces imminent insolvency or is insolvent. For instance, in 2010, directors' responsibilities and liabilities in insolvency and pre-insolvency cases were considered in the 39th session of the Committee of Working Group V.[838] As a result, specific provisions or theories have been proposed to prevent or stop such trading.

The UNCITRAL aims to provide a legislative guide for harmonising national legislation for insolvent trading[839] outlining obligations for directors to protect the legitimate interests of creditors and stakeholders in the period approaching insolvency.[840] Furthermore, UNCITRAL asserts that company directors should be given incentives to act appropriately to preserve the company's value when it is in the zone of insolvency rather than waiting for insolvency proceedings.[841]

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[837] As discussed in Chapters 4 and 5.

[838] UNCITRAL, Insolvency Law: Directors' responsibilities and liabilities in insolvency and pre-insolvency cases, UN GAOR, 39th sess, A/CN 9/WG V/WP 96 (6-10 December 2010).

[839] UNCITRAL (2007), above n 23, 16.

[840] UNCITRAL (2013), above n 492, 1.

[841] *Insolvency Law: Directors' Responsibilities and Liabilities in Insolvency and Pre-Insolvency Cases*, UN GAOR, 40th sess, A/CN.9/WG.V/WP.100 (31 October-4 November 2011).

All in all, the problem of insolvent trading is broadly recognised at the domestic level and international level as affecting a range of business sectors and causing damage to a large number of people.

Additionally, as a matter of urgency Thailand should consider reforming its currently outdated and inefficient laws, which are ultimately impeding the country's ability to develop commercially.

More specifically, as argued in previous Chapters, current Thai corporate and insolvency laws are ineffective in preventing the insolvent trading problem and have no provisions to make company directors personally liable for loss and damage resulting from continuing to trade while their company is insolvent.

These reasons and others will now be discussed to show why a reform is necessary for Thailand. In doing so, the barriers to reform will also be identified. Finally, this chapter will recommend a model law, i.e., a set of provisions to be included in Thai legislation to deal with insolvent trading in Thailand.

II WHY IS A REFORM NECESSARY?

In the light of the fact that the inefficiency of the current Thai laws adversely affects creditors, investors and the business sectors in Thailand, there are three main reasons that make it necessary for Thailand to reform the current laws.

First, according to the report of the National Council for Peace and Order of Thailand, a reform is needed because many Thai laws are out-of-date and often ineffective.[842] While the other countries discussed in previous chapters have provisions or a theory to deal with the insolvent trading problem, there is not even a single provision in Thai laws to prevent or stop insolvent trading. Hence, it is important to update Thai laws in this regard.

Second, in the matter of insolvency, creditors will usually be reimbursed proportionately, but the legal proceeding for proving their claims takes a long time.[843]

[842] Office of the Permanent Secretary of Defence, above n 34.
[843] López-de-Silanes, Buscaglia and Loayza, above n 35, 109.

This means that Thai bankruptcy law fails to protect creditors' interests.[844] Thus, it is not surprising that a reason given by the Office of the National Economic and Social Development Board of Thailand to reform Thai law is that current laws do not adequately protect injured persons.[845] This again supports the view that the law needs to be reformed as soon as possible.

Third, insolvency and reorganisation procedures pursuant to the *Bankruptcy Act 1940* are long processes and expensive for all parties.[846] Having specific insolvent trading provisions might resolve this problem. It will provide specific direction to the bankruptcy court to make orders, and impose a duty and liability on company directors in reliance of those provisions. By reforming the *Bankruptcy Act 1940,* there will be clarity for the court, directors and creditors in relation to insolvent trading.

While these factors show that law reform is needed, there are some barriers to the reform process.

III BARRIERS TO A REFORM

Obstacles to reforming the current laws to deal with insolvent trading can be separated into three main categories: first is the barrier caused by unnecessary long delays in amending the legislation because of the potential intervention of politicians or influential persons; second is resistance within the legal system – whether judges, prosecutors and so on – who lack the knowledge and skills, particularly in the case of securities law and insolvent trading issues, to interpret the law sufficiently well to recognise the benefits of reforming the law.

Data from the Legal Research Institute Foundation shows that between BE 2544-2547 (2001-2004) the Council of State received 312 drafts of laws for consideration. However, the Council of State completed only 205 of these (67.70% of the 312 drafts)

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[844] William H Overholt, 'Thailand's Financial and Political Systems: Crisis and Rejuvenation' (1999) *Asian Survey* 1009, 1012.

[845] Office of the National Econnomic and Social Development Board, 'Recommendation for Thai Reform Book 1 Office of the National Econnomic and Social Development Board' (2015) 6.

[846] Boonsri Kobboon and Pornchai Asawawattanaporn, 'The Modification Study of the Bankruptcy Act BE 2483 (Reorganization)' (Law Reform Commission, Office of the Council of State, 2002) 1.

and the Thai Parliament, which was a majority government, took more than a year to consider 48 bills, many of which directly supported the policies of their government.[847] Arguably, the problem concerning the enactment of new laws is a significant barrier to reforming laws, especially for introducing a law that is likely to be of marginal interest to politicians, such as the insolvent trading provisions. In other words, the delay and inefficiency of the legislative process can be an obstacle and constrain the development of Thailand's law in relation to insolvent trading.

Uwanno argues that the legislative procedure, from the time the law is proposed until the law is presented to the government for consideration, requires politicians to weigh up the sometimes conflicting economic and social benefits.[848] Therefore, it is not surprising that the laws of Thailand, which have deep-rooted cultural factors encouraging corruption,[849] are subject to intervention by the politicians. Trivellato similarly argues that corporate restructuring under the Thai jurisdiction has been hindered by delays in the reform of the *Bankruptcy Act 1940*. A significant reason is that the senators or some politicians are directly involved in the failures of particular businesses.[850]

The third barrier concerns the lack of understanding and knowledge of judges and related staff. For example, the judges who deal with bankruptcy law have very little expertise in dealing with that area of law.[851] Moreover, in specific law like the *SEA*, prosecutors and police officers do not have enough knowledge to understand how the securities law works.[852] These factors provide no incentive for reforming the laws

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[847] Legal Research Institute Foundation, 'The Change of Law Reform Procedure Under Thai Jurisdiction' (Law Reform Commission, Office of the Council of State, 2006) 2.

[848] Borwornsak Uwanno, *The Future of Thai Legal Structure,* Mae Fah Luang University <http://www.mfu.ac.th/school/law/admin/uploadCMS/upload/xJThu10859.pdf>.

[849] Pichit Likitkijsomboon, 'The Thai Economy: Stabilization and Reforms' (2000) *Southeast Asian Affairs* 296, 307.

[850] Benedetta Trivellato, 'Corporate and Financial Sector Reform in the Wake of the Asian Crisis: Malaysia and Thailand' (2002) 1(2) *European Journal of East Asian Studies* 221, 232.

[851] Pisut Srikajorn, *Criminal Judgement Under the Bankruptcy Law Court of Justice,* The Court of Justice <http://elib.coj.go.th/managecourt/data/B8_29.pdf>.

[852] Nisha Kanchanapoomi, 'Accelerating Corporate Governance Reform in Thailand: The Benefits of Private Reform Mechanisms' (2005) 15 *Southern California Interdisciplinary Law Journal* 165, 176.

because there are few legal experts who truly understand the problems as to how the insolvent trading problem affects the Thai business sector, investors and creditors.

This thesis, nevertheless, recommends a model law for insolvent trading for Thailand that may gain acceptance and adoption.

IV A Model Law

Making recommendations for reform and providing a model law to deal with the problem of insolvent trading for Thailand requires consideration of various approaches that other jurisdictions have taken to deal with the insolvent trading problem.

Two main courses of action for dealing with the insolvent trading problem have been identified from the legislation of the other jurisdictions examined in this thesis. First, the UK *Cork Report*[853] and the Australian *Harmer Report*,[854] identify the importance of establishing a duty and liabilities on directors to discourage such reckless trading. Similarly, the purpose of including legislative provisions relating to insolvent trading in German law was to extend the boundary of a director's personal liability in order to protect creditors' interests.[855]

The second course of action, as advocated by Purslowe,[856] Wood,[857] and Ramsay[858] is to specifically relate to protecting creditors. A decision of The Third Circuit Court in *Lemington* held that 'fiduciary duties are owed not only to the corporation and its shareholders, but also to the creditors of an insolvent entity.'[859] Clearly, creditors' protection is an important rationale for dealing with insolvent trading activities.

Establishing duties and liabilities upon directors, and protecting creditors, will form the basis for the inclusion of insolvent trading provisions into Thai law. The contention is that such law reform should be adopted to achieve efficiencies in Thai law; that is,

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[853] *Cork Report*, above n 305, [1781]-[1786].
[854] *Harmer Report*, above n 340.
[855] Casper, above n 474, 1126.
[856] Purslowe, above n 354, 119.
[857] Wood, above n 486, 156.
[858] Ramsay, above n 368, 1.
[859] *Lemington*, 659 F 3d 282, 290 (3rd Cir, 2011), 290.

replacing the current largely out-dated legislation which does not effectively cater for the current economic environment. In sum, the rationales for encouraging Thailand to reform its laws in order to effectively deal with insolvent trading are: (1) to establish a duty on directors and imposing directors' liabilities; (2) to protect creditors' interests; and (3) to update the laws to deal effectively with current economic needs.

When imposing a positive duty and specific liabilities on directors, it is necessary to ensure there is a balance between a director's need to have managerial independence, and the interests of shareholders and creditors. At the outset, to enable such a duty and liabilities to work, Thai laws need to include a statutory definition of the term 'director', which extends to '*de facto*' and 'shadow directors'. In addition, a legislative mechanism should be introduced to provide incentives to directors to take up the option of reorganisation when their companies are facing insolvency.

A *Specific Statutory Provisions on Insolvent Trading*

Given that Thai courts rarely lift the corporate veil to protect creditors' interests in the Thai legal context. Ponpai claims that there have only been a few cases where this concept has been argued in Thai courts,[860] although the need to, at times, lift the corporate veil is widely accepted in foreign jurisdictions, such as the US[861] and UK.[862] Therefore, this thesis argues that an introduction of specific provisions on insolvent trading can overcome the corporative problem because of their usual strict adherence to separate legal entity principle. Five considerations should guide the introduction of such provisions:

1 Director's Duty not to Engage in Insolvent Trading.

The four foreign jurisdictions examined for this theses – UK, Australia, US and Germany – all have specific provisions or fiduciary theory to deal with the problem of

[860] Ponpai, above n 175, 34.

[861] See also Sorawit Limparangsri, 'Piercing the Corporate Veil (3)' (2009) 3 *The Court of Justice* 221, 227-241.

[862] See also Chrispas Nyombi, 'Lifting the Veil of Incorporation under Common Law and Statute' (2014) 56(1) *International Journal of Law and Management* 66, 67-68.

insolvent trading. The UNCIRAL also provides specific recommendations to curb such trading (these were detailed in Chapter 4). A director under s 214 of the *Insolvency Act 1986* (UK) has a duty to prevent wrongful trading when a company has entered into insolvent liquidation.[863] This means that the duty will be applied when the company assets are insufficient for the payment of its debts and other liabilities, and the expenses of winding up.[864]

Under the Australian *Corporations Act 2001*, a director also has a positive duty to prevent insolvent trading.[865] In s 588G of the Act, a director is required to prevent incurring debts if a company is or will become insolvent. The US uses the fiduciary theory to impose a duty on directors: a director will have a fiduciary duty when he or she finds that their company is insolvent. In fact, the court' s decision in the *Lemington* case,[866] established that directors owe a fiduciary duty to creditors when the company is in the vicinity of insolvency. The *GmbHG* and the *AktG* impose a positive duty on a director in a case in which a company has lost equal to one half of the registered share capital. A director has a duty to call a shareholders' meeting without undue delay.[867] Also, when a company becomes illiquid or over indebted, a director has to open insolvency proceedings[868] and not make any payments.[869]

Thus, directors in all countries referred to have a positive duty to prevent insolvent trading when a company is insolvent or in the state of insolvency. A legislative amendment should be introduced as part of Thai corporate and insolvency laws reform to improve such a duty on company directors so as to protect creditors from loss or damage caused by the company's insolvent trading.

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[863] The *Insolvency Act 1986* (UK) s 214(2)(a).

[864] The *Insolvency Act 1986* (UK) s 214(6).

[865] ASIC, *10-164ad Asic Releases Guidance On a Director's Duty To Prevent Insolvent Trading* <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2010-releases/10-164ad-asic-releases-guidance-on-a-director-s-duty-to-prevent-insolvent-trading/>.

[866] *Lemington*, 659 F.3d 282, 290 ('3th Cir' 2011).

[867] *GmbHG* (Germany) s 49(3) and the *German Stock Corporation Act 2010* (Germany) s 92(1).

[868] *InsO* s 15a.

[869] *AktG* s 92.

2 A Director should have High Level of Care to Manage a Company While it is Insolvent

Creditors and shareholders will face a greater risk of losing their money or assets if a company is nearing insolvency. Insolvency can occur through many causes, including bad management by directors and world events, such as global financial and economic crises. However, regardless of the causes, when a company is insolvent, should a director still have full power to manage the company?

In the jurisdictions studied, before an application for commencement of insolvency proceedings is made, company directors do continue to have full power to conduct a company's business even if a firm is in fact in the state of insolvency or in the zone of insolvency. However, in that period directors are imposed an additional duty to prevent insolvent trading and they are required to be more careful in how they operate the company. Such duties should be outlined in legislation to prevent insolvent trading. In the US, when a company is approaching insolvency, a director's fiduciary duty is extended to creditors of that firm.[870] In Germany, directors have to call for a shareholders' meeting if a corporation loses capital share up to 50 per cent.[871] In Australia, a director must manage a firm by taking all reasonable steps to prevent incurring more debt.[872] If a director fails or violates the conditions required by the law, there are sanctions to penalise a director. Also, there is no defence available for a director who operates a company negligently to avoid personal liability for insolvent trading.

In sum, even though an enterprise comes into the state of insolvency or becomes insolvent, a company director continues to have full powers to manage the company but acquires extra duties which impose a higher level of responsibility to prevent insolvent trading. In other words, the directors' management power should not be restricted as long as they do not breach the duty to prevent insolvent trading. Reformed Thai laws should, similarly, include specific provisions to prevent insolvent trading when a company is in financial distress or has become insolvent and impose additional

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[870] *Lemington*, 659 F.3d 282, 290 ('3th Cir' 2011)

[871] *GmbHG* s 49(3) and the *German Stock Corporation Act 2010* (Germany) s 92(1).

[872] The *Corporation Act 2001* (Cth) s 588H (5).

conditions requiring a higher level of care to particularly protect the interests of creditors.

3 Subjective and Objective Tests to Verify Directors' Execution of Their Duty

New provisions to prevent insolvent trading should require a higher level of care of a director in conducting a firm when it is or becomes insolvent. To assist judges in determining whether a director has reached an appropriate standard in exercising this care, new tests are needed.

As explained in Chapter 4, US and German laws, surprisingly, do not provide a test for verifying that directors have implemented the required standard of care in operating a company while it is in financial distress. The UK's *Insolvency Act 1986* and the Australian *Corporations Act 2001* do. The tests utilise both subjective and objective standards. A director in the UK and Australia will be tested against a standard of reasonable care for not engaging in insolvent trading.[873]

The *Cork Report* recommended that the wrongful trading proposals introduce both the subjective and objective tests.[874] The Australian courts have also employed objective[875] and subjective[876] tests. For example, Einfeld J in *Metropolitan Fire Systems Pty v Miller*[877] stated that the test is 'one of objectively reasonable grounds which must be judged by the standard appropriate to a director of ordinary competence'.[878] Moreover, Mandie J held in *ASIC v Plymin*:

> What s 588G(2)(a) requires is proof of a subjective awareness by the director of grounds, whether or not the director had a 'subjective suspicion' of insolvency,

[873] See Justin Dabner, 'Insolvent Trading-Recent Developments in Australia, New Zealand and South Africa' (1994) 6(1) *Bond Law Review* 1, 27; Perry S Granof and Shirley Spira, *Understanding Insolvency and D&O Liability Outside the United States: An Introduction* <http://www.granofinternational.com/documents/brief_v40n2_granof_spira-2.pdf>.

[874] Cork, above n 305, [1782]-[1783].

[875] *Powell v Fryer* (2001) 37 ACSR 589; (2001) SASC, 76-77; *Hall v Poolman* (2007) 215 FLR 243; 65 ACSR 123 (2007) NSWSC 1330, 232.

[876] *ASIC v Plymin* (No. 1) (2003) 175 FLR 124.

[877] *Metropolitan Fire Systems Pty v Miller (1997) 23 ACSR 699.*

[878] Ibid, 703.

which grounds may be objectively characterised as reasonable grounds for suspecting such insolvency.[879]

Under UK law, s 214 (4) of the *Insolvency Act 1986*[880] provides standards which a company director has to aim to reach as judged against a reasonably diligent person concept. Likewise, under the Australian *Corporations Act* s 588G (2),[881] a company director's management will be evaluated both subjectively and objectively. An objective test, judged against what a reasonable person will do, is applied to consider the level of care a director has taken according to s 214 (a) of the UK law and s 588G (2) (b) of the Australian law. A director is also judged by a subjective test as enacted in s 214 (b) and 588G (2) (a) of the *Insolvency Act 1986* (UK) and the *Corporations Act 2001* (Cth) respectively.

Payne and Prentice explain that the objective standard is a minimum standard applied to a director while the subjective standard is applied to directors as a higher standard for insolvent trading.[882] General knowledge, skill and experience are specific to individual directors; directors who have experience and skill will take more risk in relation to being liable for breach of duty to prevent insolvent trading. However, Keay claims that if a director who has only a few years of experience in operating a company, or if his or her standard has not reached the minimum objective standard (judged against the behaviour of a reasonably diligent person), 'he or she is not able to take

[879] *Australian Securities and Investment Commission v Plymin* (No. 1) (2003) 175 FLR 124, 426.

[880] The *Insolvency Act 1986* (UK) s 214(4) provides that:

For the purposes of subsection (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both-

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has.

[881] The *Corporation Act 2001* (Cth) s 588G specifies that:

(2) By failing to prevent the company from incurring the debt, the person contravenes this section if:

(a) the person is aware at that time that there are such grounds for so suspecting; or

(b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

[882] Payne and Prentice, above n 38, 200.

advantage of that fact and be protected from liability.'[883] Therefore, the use of both subjective and objective standards for verifying directors' management during the period of a company's insolvency can provide managers with guidelines for behaviour and provide a shield to protect creditors' interests

4 Commencement of Directors' Duty to Prevent Insolvent Trading

As detailed in Chapter 5, the laws under the Thai jurisdiction do not acknowledge a state of insolvency. In the period of time from when a firm encounters financial distress to a finding by the bankruptcy court that the firm is insolvent, a company director has no extra duty in the way he manages a company. However, to prevent insolvent trading, it is necessary to impose a duty on directors when they become aware that the company is in an insolvent state.

As already discussed in Chapter 5, first, Thai corporate and insolvency laws need to recognise the insolvent state in order to impose a specific duty on directors to prevent insolvent trading. Second, the director's duty not to engage in insolvent trading should commence when a company is in the state of insolvency, such as occurs in UK, Australia and Germany, and as recommended by the UNCITRAL guidelines. For example, s 214 of the *Insolvency Act 1986* (UK) imposes such a duty.[884] Likewise, in Germany, company directors have an obligation to request that insolvency proceedings be commenced when a firm becomes illiquid or overindebted by the *InsO*.[885] These duty requirements are imposed on directors at the time when a company comes into the insolvent state.

Third, laws need to provide tests for whether a firm is solvent or insolvent: generally such tests are the balance sheet and cash flow tests (see Chapter 4).[886] The bankruptcy court of Thailand should judge a company's insolvency by applying these two tests; that is the balance sheet and cash flow tests, rather than strictly applying only the

[883] Keay (2007), above n 303, 88-89.
[884] Rehman, above n 599, 61.
[885] The *Insolvency Statute 1994* (Germany) s 15a.
[886] Both tests are important for assessing solvency and insolvency of a company. Dismissing one of the tests would not be correct. This idea is the same as Owen J's argument in *Bell Group Ltd (in liq) v Westpac Banking Corporation* and the notion of David Morrison as mentioned in Chapter IV.

balance sheet test provided for in the *Bankruptcy Act 1940*.[887] Margret asserts that the balance sheet and cash flow tests are utilised by courts around the world, except Australian courts, which use only the cash flow test.[888] Owen J claims that both tests are important to verify a company's insolvency.[889] Thus this thesis suggests that to judge whether a company is solvent or insolvent, the Thai Bankruptcy Court should apply the balance sheet and cash flow tests.

Fourth, as discussed in Chapter 5, all current insolvency presumptions under the Thai *Bankruptcy Act 1940* can be utilised to verify whether a company is insolvent. Fifth, the SEC of Thailand should provide indicators, as modelled by ASIC in Australia, that can be used by a company director to determine when his or her company is insolvent. Knowing when the company is insolvent with help directors to avoid the liabilities that attach from engaging in insolvent trading.

Figure 6.1 outlines when a director's duty not to engage in insolvent trading should commence. To reform Thai corporate and insolvency laws, the term insolvent state should be recognised and a directors' duty to prevent unreasonable activities should be acknowledged when a company is in that state.

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[887] Overholt, above n 844, 1018.

[888] Margret, above n 625, 60.

[889] *The Bell Group Ltd (in liq) v Westpac Banking Corporation* (No 9) (2008) 225 FLR1, [1074]-[1075]. Owen J claims: 'The proposition that a balance sheet assessment continues to have some relevance is supported by other authorities … In this litigation, my primary focus is on the cash flow test. But, as will become apparent, it is necessary to look at the balance sheets to resolve some particularly contentious issues.'

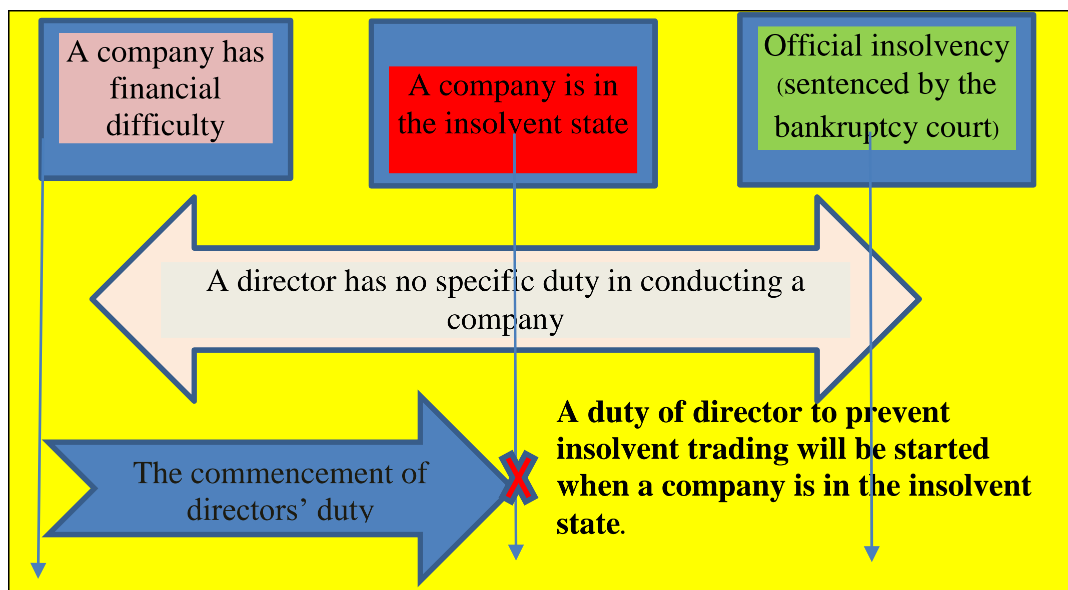

Figure 6.1: Commencement of director's duty to prevent insolvent trading under the Thai jurisdiction

5 Liabilities and Remedies[890]

In Chapter 4, three sets of liabilities attracting penalties were identified as applying to directors who traded while their company was insolvent. The liabilities are both civil and criminal. A director may also be disqualified from continuing to act as a director. Table 6.1 shows the penalties that can be applied to a director who carries out insolvent trading in the various countries studied in this thesis.

Table 6.1: Comparing liabilities of directors under various jurisdictions

Country	Liabilities		
The United Kingdom	**Civil**	-	**Disqualify director**
Australia	**Civil**	**Criminal**	**Disqualify director**
Germany	**Civil**	**Criminal**	-
The United States	**Civil**	**Criminal**	-

(a) *Civil Liability*

Civil liability provisions can be considered one of the most important liabilities to impose on a company director who violates a duty not to engage in insolvent trading. Civil liability is used in every country referred to. It acknowledges that damages caused

[890] Liabilities and remedies as specified by the *UNCITRAL Legislative Guide* will not be analysed because they are broadly identified, as discussed in Chapter 4.

by insolvent trading leads to financial and/or property losses for creditors and also shareholders. Thus, the award of compensatory damages is a popular remedy for injured parties such as creditors or investors.

Courts in the UK have been given a wide discretion, pursuant to s 214, 'in deciding on the amount of contribution that is to be paid.'[891] As Knox J states in *Re Produce Marketing Consortium Ltd,*[892] the court may order a director to repay or restore the money as the court thinks fit.[893] Section 214 is not penal but is compensatory.[894] Thus civil liability, according to s 214, is dependent on a court's discretion. In contrast, the Australian *Corporations Act 2001* specifies that a breach of s 588G has civil consequences because the section is a civil provision under s 1317E. In terms of civil liabilities, the Australian courts can make one or more orders to a director, who contravenes a duty to engage in insolvent trading, through a compensation order[895] or by imposing a pecuniary penalty.[896] For a compensation order, a court may enjoin the director to personally pay to the company compensation equal to the amount of that loss or damage. Also a court may order the director to personally pay the Commonwealth a pecuniary penalty of up to A$200 000 if there is evidence as required by s 1317G.

Under German law, a director has to pay compensation for payments made after the firm becomes illiquid or overindebted.[897] The law does not specify a minimum or maximum amount of compensation; a German court can use its discretion to determine the proper amount to compensate the company. Last, under the fiduciary duty of the US, there is no certain civil liability provided for a director. Hence, similar to the UK situation, US courts are free to set their own liability amount. Table 6.2 summarises the civil liability rules of the various jurisdictions.

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[891] Keay and Murray, above n 620, 42.
[892] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.
[893] Ibid [597].
[894] Ibid.
[895] The *Corporation Act 2001* (Cth) s 588J, 588M and 1317H.
[896] The *Corporation Act 2001* (Cth) s 1317G.
[897] *GmbHG* s 64.

Giving courts a wide discretion with respect to civil liabilities for insolvent trading is accepted in all countries. However, Australian law specifies the conditions narrowly for compensation, which is equal to the amount of that loss or damage.[898]

Table 6.2: Civil liabilities for insolvent trading

Country	Civil Liabilities
The UK	**It depends on courts' discretion**
Australia	**- Compensation order: director may pay to the company for compensation equal to the amount of that loss or damage** **- Pecuniary penalty: A court may order a director to pay the Commonwealth up to $200,000 if there was evidence as legislated in s 1317G.**
Germany	**A director has to compensate for a payment made after the firm becomes illiquid or over-indebted.** **(However, the law does not specify a minimum or maximum amount of compensation. The German court can use its discretion to determine the proper amount to compensate the company)**
The US	**It depends on courts' discretion**

As shown in the table above, this author believes that civil liability for insolvent trading should only be provided to compensate those affected by insolvent trading; the compensation can reimburse losses and damages incurred by creditors or investors. A pecuniary penalty may not be necessary for protecting creditors' interests. The reason is that creditors who suffer from insolvent trading can be recovered by compensation. Thus, imposing a pecuniary penalty to a director may not be a first option that creditors desire.

(b) ***Criminal Liability***

Of the jurisdictions studied in this thesis, only the UK law does not apply a criminal liability to a director for engaging in insolvent trading. The UNCITRAL guidelines also do not recommend the imposition of a criminal liability. However, Australia, the US and Germany have provisions for imposing criminal liabilities (see Table 6.3).

Table 6.3: Criminal liabilities for insolvent trading

Country	Criminal Liabilities

[898] See the *Corporation Act 2001* (Cth) s 588J, 588M.

The UK	No criminal liability-
Australia	A director may face a criminal penalty up to $220,000 or be imprisoned for up to five years.[899]
Germany	Failure to discharge a duty to call a meeting - A director shall be punished by imprisonment of up to three years or by a fine.[900] Failure to discharge a duty to initiate insolvency proceeding - A director shall be punished by imprisonment for not more than three years or by a fine. (However, if a director acts negligently, he or she will be punished for not more than one year or by a fine.)[901]
The US	It depends on the courts' discretion

Arguably, imposing criminal liabilities for engaging in insolvent trading has the potential to have a greater influence on a director's behaviour than imposing civil liabilities; that is, the possibility of imprisonment would weigh heavily on the mind of a director considering activities that could be held to be insolvent trading. Therefore, imposing criminal liability on a director who violates insolvent trading is a very effective protection for creditors and a strong incentive for a director to achieve an appropriate standard of care in managing the company. Also, the imposition of a specific duty and criminal liability on a company director can resolve the problem of the burden of proof. In other words, the burden of proof will be shifted to a director who has to show that he or she managed a firm efficiently with an appropriate conduct of care and diligence required by the law.

With regard to the period of time for imprisonment, it will be necessary to consider the characteristics of the insolvent trading: a company director may be negligent or careless in his management of the firm but he may not have intended to swindle or defraud creditors or investors. Thus, criminal liability, such as imprisonment, should not be greater than the maximum set by Thailand's *Criminal Code 1956*, in which a person who contravenes a law by cheating and fraud shall be punished with imprisonment not exceeding a maximum of seven years.[902]

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[899] ASIC, *Regulatory Guide 217*, above n 746.
[900] *GmbHG* s 84 and *AktG* s 401.
[901] The *Insolvency Statute 1994* (Germany) s 15(a) (4) and (5).
[902] The *Criminal Code 1956* (Thailand) s 343.

This author asserts that the period of imprisonment should be up to and no more than five years. The high level of the penalty could increase the awareness of a director of the need to practise good management of his insolvent company. Though the proposed model law suggests a maximum period of imprisonment of five years, a Thai court can use its own discretion in imposing the most appropriate sentence on a director who carries out insolvent trading.

(c) Disqualification

Under the *Company Directors Disqualification Act 1986* (UK) and the *Corporations Act 2001* (Cth), a court may make a disqualification order against directors who breach their duties which are civil penalty provision.[903] However, this type of penalty does not appear in US and German laws in the case of insolvent trading.

Section 10 of the *Company Directors Disqualification Act* (UK) specifies that when a UK court makes a declaration to a person who contravenes s 214 of the *Insolvency Act*, the court may also impose a disqualification order against that person.[904] A person may be disqualified from taking up a director's position for up to 15 years for violating insolvent trading provisions.

Section 206C of the *Corporations Act 2001* (Cth) provides a court may make an order disqualifying a person from managing a corporation for a period of time which a court thinks is proper.[905] An Australian court may disqualify a company director for up to

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[903] See, eg, the Corporation Act (Cth) ss181, 182, 183 and 1317E.

[904] The *Company Directors Disqualification Act 1986* (UK) s 10 provides:

(1) Where the court makes a declaration under s 213 or 214 of the Insolvency Act that a person is liable to make a contribution to a company's assets, then, whether or not trading an application for such an order is made by any person, the court may, if it thinks fit, also make a disqualification order against the person to whom the declaration relates.

(2) The maximum period of disqualification under this s is 15 years.

[905] The *Corporations Act 2001* s 206C Court power of disqualification--contravention of civil penalty provision state:

'(1) On application by ASIC, the Court may disqualify a person from managing corporations for a period that the Court considers appropriate if:

(a) a declaration is made under:

(i) s 1317E (civil penalty provision) that the person has contravened a corporation/scheme civil penalty provision; or

ten years, if disqualification is justified.[906] Moreover, the *Corporations Act 2001* (Cth) gives a power to ASIC to disqualify a person from managing a corporation for up to five years.[907]

Table 6.4 summarises director's disqualification periods under the various jurisdictions studied in this thesis.

Table 6.4: Disqualification liabilities for insolvent trading

Country	Disqualification liability for insolvent trading
The UK	**The *Company Directors Disqualification Act 1986*: a person can be disqualified up to fifteen years which is a maximum period of time**
Australia	**The *Corporations Act 2001*:**

(ii) s 386-1 (civil penalty provision) of the Corporations (Aboriginal and Torres Strait Islander) Act 2006 that the person has contravened a civil penalty provision (within the meaning of that Act); and

(b) the Court is satisfied that the disqualification is justified.

(2) In determining whether the disqualification is justified, the Court may have regard to:

(a) the person's conduct in relation to the management, business or property of any corporation; and

(b) any other matters that the Court considers appropriate.

(3) To avoid doubt, the reference in paragraph (2)(a) to a corporation includes a reference to an Aboriginal and Torres Strait Islander corporation'

[906] The *Corporations Act 2001* s 206D Court power of disqualification—insolvency and non-payment of debts

'(1) On application by ASIC, the Court may disqualify a person from managing corporations for up to 10 years if:

(a) within the last 7 years, the person has been an officer of 2 or more corporations when they have failed; and

(b) the Court is satisfied that:

(i) the manner in which the corporation was managed was wholly or partly responsible for the corporation failing; and

(ii) the disqualification is justified.'

[907] The *Corporations Act 2001* s 206F ASIC's power of disqualification states:

'(1) ASIC may disqualify a person from managing corporations for up to 5 years if:

(a) within 7 years immediately before ASIC gives a notice under paragraph (b)(i):

(i) the person has been an officer of 2 or more corporations; and

(ii) while the person was an officer, or within 12 months after the person ceased to be an officer of those corporations, each of the corporations was wound up and a liquidator lodged a report under subsection 533(1) (including that subsection as applied by section 526-35 of the Corporations (Aboriginal and Torres Strait Islander) Act 2006) about the corporation's inability to pay its debts; and

(b) ASIC has given the person:

(i) a notice in the prescribed form requiring them to demonstrate why they should not be disqualified; and

(ii) an opportunity to be heard on the question; and

(c) ASIC is satisfied that the disqualification is justified.

	A court may disqualify a company director up to ten years if the disqualification is justified. (s 206D) **ASIC may disqualify a company director up to five years. (s 206F)**
Germany	-
The US	-

It is remarkable that with regard to disqualification, the Australian law gives a power to an Australian court and ASIC to order a company director violating the law to be disqualified in that position for up to ten years and five years respectively. On the other hand, the UK law gives the disqualification power to a court only. However, a UK court can disqualify a director for up to 15 years, which is a longer period than that specified in the Australian law.

As explained in Chapter IV, a disqualification order for insolvent trading may not be the main sanction which can protect all creditors' interests or affect a director significantly. However, this penalty can apply to protect society for a period of time. A director who is disqualified by a court or an ASIC order cannot be involved in directing companies. Thus, a possibility for insolvent trading will be reduced because the same director who fails to manage a company could not work in the same field or do related work.

With reference to Thai cultural disputes, most cases should be decided by the bankruptcy courts. Therefore, this author asserts that the *Bankruptcy Act 1940* should preferably provide courts with the power to disqualify a defendant who trades while his company is insolvent. The maximum penalty should not be over five years, the same as for the criminal liability.

As regards remedies, insolvent trading has an enormous effect on the finance sector. Creditors who suffer from insolvent trading will, if the provisions recommended are adopted, be able to access compensation, and both civil and criminal sanctions, including disqualification, will be imposed on directors. However, it is submitted that the maximum compensation (civil liability) should be determined by courts because it depends on the specific circumstances of the company.

6 Recommended Insolvent Trading Provisions

As explained in (a)-(e) above, it is important, when establishing a model law to prevent insolvent trading, that particular attention is paid to determining which Thai law or act should be amended to include the new provisions concerning the duty of a director not to engage in insolvent trading. This author asserts that insolvent trading is very closely related to insolvency. Thus, the appropriate law which should impose a duty on a director not to engage in insolvent trading is the *Bankruptcy Act 1940*. This Act is particularly relevant because it applies to all kinds of companies, whether private or public company. In other words, by amending this law, a duty is created for directors of all types of companies.

The question is, which chapter of the *Bankruptcy Act 1940* should be amended to include the new insolvent trading provisions? As explained in Chapter 2, there are currently eight chapters in that Act. It is reasonable to argue that Chapter 3 is the most appropriate one for adding the insolvent trading provisions. [908] However, the *Bankruptcy Act 1940* is not a law which can directly impose a duty on a director, unlike the *CCC*, *PLC* and *SEA*. All provisions referred to in the Act are about presumptions, procedures, sanctions and penalties. Thus, amendment of this law alone may not be sufficient to prevent insolvent trading.

There is a need to create new insolvent trading provisions to impose a specific director's duty. These new insolvent trading provisions should be added to the *Bankruptcy Act* as follows:

(1) Where the court issues a receivership order against a company that is insolvent, whether a private or public company, if the facts illustrate to the receiver that a director of the company at that time suspected that the company is in an insolvent state or will become insolvent by incurring a debt, and a director fails to prevent the company from incurring that debt, the receiver may request the court to order a director, some or all directors

[908] Chapter III is proceedings in case of the debtor with the status as an ordinary partnership, a limited partnership, a limited company or any other juristic person.

to compensate the company or creditors who suffered for any damages incurred in an amount which the court thinks proper.

(2) For the purpose of (1), the director will not be liable if it is proved that the director conducted the company in the same way that a person would be aware at that time by taking in to account of:

(a) the general knowledge, skill and experience of a reasonable person in a like position of director would do, and

(b) the general knowledge, skill and experience of that director has.[909]

(3) Where the court finds that one or some directors violate the duty under (1) by absence of excuse under (2), the court shall order one or some directors to compensate any damages incurred by paying an amount back to the company's assets. The criminal liability and disqualification sanction shall be applied to a director. A maximum penalty of five years imprisonment and disqualification may be applied.

7 Defence

Defences form a significant part of insolvent trading provisions. Table 6.5 summaries the defences available to directors in the various jurisdictions studied for this thesis.

Table 6.5: Defences for insolvent trading

Country	Defences for Insolvent Trading
The UK	**S 214 (3)** **'The court shall not make a declaration under this s with respect to any person if it is satisfied that after the condition specified in subs (2)(b) was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors as (assuming him to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) he ought to have taken.'**
Australia	**S 588H** **• Reasonable grounds to expect that the company is solvent;** **• Reasonable grounds to believe a reliable person about the information;** **• Illness or other good reason showing that he or she did not take part in the company management; or** **• Reasonable steps were taken to prevent the incurred debt**
The US	**The Business Judgment Rule**

[909] (2) is a copy of s 214 (4) (b) of the *Insolvency Act 1986* (UK)

	'the business judgment rule should insulate officers and directors from judicial intervention in the absence of fraud or self-dealing, if challenged decisions were within the scope of the directors' authority, if they exercised reasonable diligence, and if they honestly and rationally believed their decisions were in the best interests of the company.'
Germany	**No defence available for failing initiate insolvency proceedings (there is a defence for a director in only a listed company who makes any payment after the company has become insolvent with the care of a diligent and conscientious manager according to s93)**

As stated in Chapter 4, there are problems with some of these laws. First, a defence under the UK law is likely to be difficult to establish. The wording 'every step' leads to an uncertain outcome. It is hard to make out the defence under s 214 (3) that a company director took every step to minimise a potential loss.[910] Keay and Murray suggest that the words 'every step' under s 214(3) are too strong. It is almost impossible to prove and it is extremely vague.[911]

In practice, the defence for wrongful trading under the UK law, therefore, is not practical, because directors cannot guarantee that every step of their management will direct the company toward a successful track. While the legal context of the UK cannot be utilised properly in practice, the business judgment rule being a defence for a director under the US jurisdiction is not created as a concrete object. Hence it is too abstract for application in the Thai legal cultural setting.

There is no available defence for a director who fails to call a meeting when a firm has lost up to 50 per cent of share capital under German law.[912] As Bachner emphasises, there is no defence for a director who fails to initiate insolvency proceedings, or makes any payment after a company has become illiquid or over-indebted.[913] Nevertheless, in the case of a public enterprise, there is a defence available when a director makes a payment after a company has become illiquid or over-indebted if a director can argue

[910] Hirt, above n 40, 92.

[911] Keay and Murray, above n 620, 45.

[912] The *GmbHG 1892* s 43(3) and the *AktG* s 92(1).

[913] Bachner, above n 471, 307. This is an absolute liability provision as s 588G of the *Australian Corporations Act 2001*.

that he or she managed the company with the care and diligence of a conscientious manager.[914] The German law is probably too strict regarding a duty of a director to prevent insolvent trading.

The Australian *Corporations Law 2001* s 588H provides four main options for a company director to defend his or her management in the case of insolvent trading:

- Reasonable grounds to expect that the company is solvent;
- Reasonable grounds to believe a reliable person about the information;
- Illness or other good reason showing that he or she did not take part in the company management; or
- Reasonable steps taken to prevent the incurred debt.

When compared to provisions in other jurisdictions, the defences against insolvent trading under Australian corporation law seem the most concrete and reasonable. Therefore, Thailand should adopt such defences into its model provisions to deal with the problem of insolvent trading.

The recommended defences for insolvent trading are as follows:

A director can defend themselves if:

(a) There are reasonable grounds to believe that a company is solvent;

(b) There are reasonable grounds to believe that information from a reliable person showing that a company is solvent;

(c) A director did not take part in the company management because of illness or other good reason; or

(d) Reasonable steps are taken to prevent the incurred debt.

In conclusion, the Thai *Bankruptcy Ac*t should be amended by adding new insolvent trading provisions to stop such reckless trading and also impose a duty and liability on a company director and other officers who are careless or negligent in managing a company when a company is in the insolvent state in order to protect the country's

[914] *GmbHG* s 92(2).

economy and creditors' interests. As noted above, insolvent trading provisions should most appropriately be added to Chapter 3 of the Thai *Bankruptcy Act 1940*.

B *Definition of a Director*

As discussed in Chapter 3, Thai regulations, whether the *CCC*, the *PLC* or the *SEA*, do not define the meaning of directors. Thai law provides only that 'a director can be appointed or removed by a general meeting.'[915] However, the word director only refers to executive and non-executive directors, pursuant to the Thai Supreme Court's decisions. Moreover, the Thai Supreme Court has not mentioned that it relied upon the notion of 'shadow director' in any of its cases. This is probably because Thai courts adhere to the black letter law and, therefore, interpret matters strictly according to the literal wording of the legislation. If the code or acts do not refer to the term 'shadow director' then the Thai courts cannot make or create a law or presume to recognise a further category of director. Therefore, there is no acknowledgment that persons can hold the position of shadow director in a company, even though it is accepted that many companies in Thailand are controlled by shadow directors. It is important that the law recognises that directors, whether appointed directors, *de facto* directors or shadow directors, should be held liable for insolvent trading. For this reason, the definition of director is necessary and required.

The definition of a director is expressly embedded in the *Companies Act 2006* and the *Corporations Act 2001* (Cth) under the UK and Australian jurisdictions respectively. US and German laws do not explicitly provide a definition of the notion of 'director'.

The meaning of 'director' for insolvent trading in both the UK[916] and Australia[917] is similar and includes *de jure* and *de facto* or shadow directors.[918] Nevertheless, for the

[915] *CCC* s 1151.

[916] The *Company Act 2006* (UK) s 250.

[917] The *Corporation Act 2001* (Cth) s 9.

[918] See, eg, Héctor José Miguens, 'The Insolvent Subsidiary and Liability of the Parent Corporation in the USA, Argentina, and UNCITRAL' (2010) 19(3) *International Insolvency Review* 239, 250; Ali Imanalin, 'Rethinking Limited Liability' (2011) 7 *Cambridge Student Law Review* 89, 94; Reece Walker, 'Applied Corporate Governance: Corporate Advisory Boards-Pros and Cons' (2012) 64(3) *Keeping Good Companies* 139, 142.

Australian law, in certain situations a person could be assumed to be a director who conducts the company business[919] and can include alternate directors if called upon to act as directors for a company.[920]

UK law provides a broad definition of a director, though it is, nevertheless, unclear. Barlow claims that the UK courts have to interpret the meaning of directors by looking at the facts and circumstances of each situation and the courts will not place importance on a person's title alone.[921]

Both UK[922] and Australian law[923] provide the same sense of meaning to shadow director. Significantly, a shadow director can include a juristic person. This means that a juristic person can be liable if involved in insolvent trading by acting as a shadow director. The Australian *Corporations Act 2001*, in the case of insolvent trading, specifically states that a holding company can be liable for insolvent trading by a subsidiary.[924] However, both the regulation in the UK and Australia stipulate that a person, acting in a professional capacity, whose advice functions as that of a company director, will not be liable for insolvent trading as a shadow director.[925]

To create a definition of director under Thai law, it is necessary to have a concrete definition for the courts because of their preference for literal interpretations. The Australian *Corporations Act 2001* appears to provide the more precise definition and, hence, Thailand should adopt that definition of director.

In terms of shadow director, the definition referred to in the UK and Australia laws is basically the same. Thus, either definition can be used as a model to construct a definition for a shadow director for Thai law.

[919] The *Corporation Act 2001* (Cth) s 129.
[920] See *Playcorp Pty Ltd v Shaw*, (1993) 10 ACSR 212, 11 ACLC 641.
[921] Barlow, above n 502.
[922] The *Company Act 2006* (UK) s 251.
[923] The *Corporation Act 2001* (Cth) s 9.
[924] The *Corporation Act 2001* (Cth) s 588V.
[925] The *Company Act 2006* (UK) s 251 and the *Corporation Act 2001* (Cth) s 9(b)(ii).

In order to reform Thai laws to prevent insolvent trading, this thesis suggests that the definition of director include three elements. First, the definition of director (including the definition of shadow director) should be included in one piece of legislation which can be enforced regardless of whether a private or public company is involved. The *Bankruptcy Act 1940* is the main law controlling all private and public companies in the case of an insolvent company. Therefore, the *Bankruptcy Act 1940* should be where the definition of director, concerning insolvent trading, should be inserted, rather than including the meaning of director in the *CCC*, the *PCL* or *SEA*.

Second, the definition of a director for Thai law should use the Australian *Corporations Act 2001* as a model to define the meaning of director. The definition of a director pursuant to the *Corporations Act* is precise and clear. A director should be defined to include *de jure* and *de facto* director. In addition, in a case of insolvent trading, the meaning of directors should be extended to a person who has been duly appointed and has authority to exercise power as a director.[926] Therefore, to reform Thai law, the definition of director recommended is as follows:

> Director of a company means:
>
> (a) a person who:
>
> (i) is appointed to the position of a director; or
>
> (ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position.[927]

Third, the important part concerning the directors' duty to prevent insolvent trading is the need for a definition of 'shadow director'. Especially, regarding a parent company, a shadow director can be a legal entity whether it is a holding or subsidiary company if its instructions or wishes are acted upon by a company's director. As explained, a shadow director in Thailand does not have any liability for any mistake or negligence of management even though there are a number of companies controlled by shadow

[926] The *Corporation Act 2001* (Cth) s 129(2).
[927] Definition of director is adopted from s 9 of the Australian *Corporations Act 2001*.

directors. Therefore, it is necessary to impose a duty and liability on a shadow director who carries out insolvent trading. This leads to the need to have a definition of a shadow director. As already noted, the definitions of a shadow director in the UK and Australia have the same meaning and provide an appropriate model for Thailand. The following definition of a shadow director is recommended:

> A shadow director is a person or legal entity whose instructions or wishes are acted upon by a company director.

Therefore, with the definition of director as suggested, a director who has a duty and liability in the case of insolvent trading is a *de jure* director, a *de facto* director, a shadow director and also a person, in certain situations, who can be assumed to be a director conducting a company business. Nevertheless, a person who gives advice as a professional will not be held to be a shadow director.[928] Thus, the exception for a shadow director should be mentioned as follows.

> A person is not to be regarded as a shadow director simply because the directors act on advice given by him in a professional capacity.[929]

In conclusion, the recommendation of the definition of director for insolvent trading for Thailand is that
director of a company means:

(a) a person who:

(i) is appointed to the position of a director; or

(ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position

(b) A shadow director is a person or legal entity whose instructions or wishes are acted upon by a company director. However, a person is not

[928] Paul R Ellington and Ian M Fletcher, 'Responsibility and Liabilities of Directors and Officers of Insolvent Corporations in the UK' (1988) 16 *International Business Lawyer* 491, 492.
[929] The *Companies Act 2006* (UK) s 251 (2) is a model for this exception.

to be regarded as a shadow director simply if the directors act on advice given by him in a professional capacity.

C *Amendment of the Provision for Reorganisation*

One reason leading to the insolvent trading problem under Thai law is that the law provides no option or a way for a director to consider reorganisation when a company is nearing insolvency. In other words, the Thai *Bankruptcy Act* does not provide an effective option for directors to cure a company out of its financial difficulty. It is suggested that the insolvent trading problem would arise less frequently if companies cannot exceed a certain minimum amount of debts as required by the *Bankruptcy Act 1940*. At present, if the debts of a company do not reach THB10 000 000,[930] directors do not have the right to commence a course of action to reorganise a company. In fact, a company may be or be on the verge of insolvency even though the amount of its debt is less than THB10 000 000.[931] Barameeauychai argues that a company which may be illiquid or does not have enough money at that time but is not insolvent, cannot claim any benefits or advantages from the reorganization provision of the current legislation.[932] For this reason, Puangnamee concludes that specifying a minimum debt (THB10 000 000) before a company can consider reorganising is not suitable for Thai society.[933]

In other jurisdictions, a company director has a chance to judge whether the firm should be reorganised. This means that a director can decide whether (1) the company should opt for reorganisation or be put into the hands of an administrator; or (2) the company should continue because the business appears to be improving. Other jurisdictions considered in this thesis do not impose a minimum debt before directors

[930] The *Bankruptcy Act 1986* (Thailand) s 90/3-90/4.

[931] Kitipong Urapeepatanapong, Sawanee Sethsathira and Chirachai Okanurak, 'New Bankruptcy Act To Boost Thai Economy' (1998) 17(4) *International Financial Law Review* 33, 36.

[932] Kraisorn Barameeauychai, *Reorganization Law for Debtors,* Judicial Trainng Institute <http://elib.coj.go.th/managecourt/data/B2_2.pdf>.

[933] Jaras Puangmanee, *Rehabilitation of Debtors: Case Study on the Bankruptcy Act BE 2483* Judicial Trainng Institute <http://elib.coj.go.th/managecourt/data/B2_6.pdf>.

can opt for reorganisation or to be placed in the hands of an administrator. The options concerning the reorganisation under various countries are summarised in Table 6.6.

Table 6.6: Options for directors when a company is approaching insolvency

Country	Options for a company director when a company is approaching insolvency
The United Kingdom	**Administration Procedure** **The *Insolvency Act* s 8[934] and 9[935]- an option called administration for directors in order to rescue the company or its business. Directors can file an application to a court for ordering the company's administration.**

---

[934] The *Insolvency Act* 1986 (UK) s 8 provides:

'(1) Subject to this section, if the court—

(a) is satisfied that a company is or is likely to become unable to pay its debts (within the meaning given to that expression by section 123 of this Act), and

(b) considers that the making of an order under this section would be likely to achieve one or more of the purposes mentioned below, the court may make an administration order in relation to the company.

(2) An administration order is an order directing that, during the period for which the order is in force, the affairs, business and property of the company shall be managed by a person ('the administrator') appointed for the purpose by the court.

(3) The purposes for whose achievement an administration order may be made are—

(a) the survival of the company, and the whole or any part of its undertaking, as a going concern;

(b) the approval of a voluntary arrangement under Part 1;

(c) the sanctioning under section 425 of the Companies Act of a compromise or arrangement between the company and any such persons as are mentioned in that section; and

(d) a more advantageous realisation of the company's assets than would be effected on a winding up; and the order shall specify the purpose or purposes for which it is made.

(4) An administration order shall not be made in relation to a company after it has gone into liquidation, nor where it is—

(a) an insurance company within the meaning of the Insurance Companies Act 1982, or

(b) a recognised bank or licensed institution within the meaning of the Banking Act 1979, or an institution to which sections 16 and 18 of that Act apply as if it were a licensed institution.'

[935] The *Insolvency Act 1986* (UK) s 9 Application for order states:

'(1) An application to the court for an administration order shall be by petition presented either by the company or the directors, or by a creditor or creditors (including any contingent or prospective creditor or creditors), or by all or any of those parties, together or separately.

(2) Where a petition is presented to the court—

(a) notice of the petition shall be given forthwith to any person who has appointed, or is or may be entitled to appoint, an administrative receiver of the company, and to such other persons as may be prescribed, and

(b) the petition shall not be withdrawn except with the leave of the court

(3) Where the court is satisfied that there is an administrative receiver of the company, the court shall dismiss the petition unless it is also satisfied either—

(a) that the person by whom or on whose behalf the receiver was appointed has consented to the making of the order, or

(b) that, if an administration order were made, any security by virtue of which the receiver was appointed would—

Australia	**Voluntary Administration** **The *Corporations Act* s 436A[936]- directors can appoint an administrator if the result of directors' voting shows that the company will become insolvent**
The United States	**Voluntary Petition** **The *Bankruptcy Code* s 1121[937]- an option concerning reorganisation to directors when the company has financially troubled business**
Germany	**Opening Insolvency Proceedings** **The *Insolvency Statue* s 18[938]- This law does deliver a right for directors for opening of insolvency proceedings when a company is in imminent insolvency**

An amount of debt is not mentioned in any of the laws of the other countries. Moreover, when a company is in financial trouble or in imminent danger of insolvency, a director is allowed to ask to enter into the administration procedure under the UK law,

(i) be liable to be released or discharged under sections 238 to 240 in Part VI (transactions at an undervalue and preferences),
(ii) be avoided under section 245 in that Part (avoidance of floating charges), or
(iii) be challengeable under section 242 (gratuitous alienations) or 243 (unfair preferences) in that Part, or under any rule of law in Scotland.
(4) Subject to subsection (3), on hearing a petition the court may dismiss it, or adjourn the hearing conditionally or unconditionally, or make an interim order or any other order that it thinks fit.
(5) Without prejudice to the generality of subsection (4), an interim order under that subsection may restrict the exercise of any powers of the directors or of the company (whether by reference to the consent of the court or of a person qualified to act as an insolvency practitioner in relation to the company, or otherwise).'

[936] The *Corporations Act 2001* (Cth) s 436A provides:
'Company may appoint administrator if board thinks it is or will become insolvent
(1) A company may, by writing, appoint an administrator of the company if the board has resolved to the effect that:
(a) in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time; and
(b) an administrator of the company should be appointed.
(2) Subsection (1) does not apply to a company if a person holds an appointment as liquidator, or provisional liquidator, of the company.

[937] The *Bankruptcy Code* Chapter 11 s 1121 states:
(a) The debtor may file a plan with a petition commencing a voluntary case, or at any time in a voluntary case or an involuntary case.

[938] The *Insolvency Statue* 1994 s 18 Imminent Insolvency states:
(1) If the debtor requests the opening of insolvency proceedings, imminent insolvency shall also be a reason to open.
(2) The debtor shall be deemed to be faced with imminent insolvency if he is likely to be unable to meet his existing obligations to pay on the date of their maturity.
(3) If in the case of a legal person, or of a company without legal personality, the request is not filed by all members of the board of directors, all general partners or all liquidators, subsection (1) shall only apply if the person or persons filing the request are empowered to represent the company or the partnership.

voluntary administration in the Australian case, and voluntary petition or opening insolvency proceedings under the US and German laws respectively.

Thus, not limiting the amount of debt can be an incentive for a company director to apply this option to avoid trading while a company is insolvent and prevent personal liability. Nevertheless, in order to allow a company director to file a petition for reorganisation, a significant point is that a petition must be approved by a court. The main reason is that reorganisation can be an opportunity or a path for a director to avoid personal liability from insolvent trading. Thus, reorganisation must be allowed by a court.

To solve the problem of insolvent trading, this thesis recommends that the Thai *Bankruptcy Act 1940* be amended by deleting the provision for a minimum of debt required before a company director can utilise the reorganisation option. In addition, the Act should include a provision that a petition of reorganisation should be submitted by a company director to a court for approval.

In addition, the Securities and Exchange Commission (SEC) of Thailand should provide indicators that will help directors to determine when a company might be insolvent, as ASIC does in Australia.

All in all, there are three components to reforming the Thai *Bankruptcy Act 1940*: specific liability provisions, definition of the notion of 'director', and amendment of reorganisation. These are summarised in Table 6.7.

Table 6.7: A recommendation for reform of the Thai *Bankruptcy Act 1940*

The current provision	A recommendation provision
Chapter III	**Chapter III** **S 88/1 (1) Where the court issues a receivership order against a company that is insolvent, whether a private or public company, if the facts illustrate to the receiver that a director of the company at that time suspected that the company is in an insolvent state or will become insolvent by incurring a debt, and a director fails to prevent the company from incurring that debt, the receiver may request the court to**

	order a director, some or all directors to compensate the company or creditors who suffered for any damages incurred in an amount which the court thinks proper. A director in this section means (a) a person who (i) is appointed to the position of a director; or (ii) is appointed to the position of an alternate director and is acting in that capacity; regardless of the name that is given to their position. (b) A shadow director who is a person or legal entity whose instructions or wishes are accustomed to act by a company director. However, a person is not to be regards as a shadow director by reason only that the directors act on advice given by him in a professional capacity. S 88/2 For the purpose of 88/1, the director will not be liable if it is proved that the director conducted the company in the same way that a person would be aware at that time by taking in to account of: (a) the general knowledge, skill and experience of a reasonable person in a like position of director would do, and (b) the general knowledge, skill and experience of that that director has. S 88/3 A director can defend himself or herself if: (a) There are reasonable grounds to believe that a company is solvent; (b) There are reasonable grounds to believe that information from a reliable person showing that a company is solvent; (c) A director did not take part in the company management because of illness or other good reason; or (d) Reasonable steps are taken to prevent the incurred debt. S 88/4Where the court finds that one or some directors violate the duty under 88/1 by absence of excuses under ss88/2 and 88/3, the court shall order one or some directors to compensate any damages incurred by paying an amount back to the company's assets. The

	criminal liability and disqualification sanction shall be applied to a director. A maximum penalty of five years imprisonment and disqualification may be applied.
Reorganisation **Section 90/3. When the debtor becomes insolvent and is indebted to one creditor or several creditors altogether in a definite amount of not less than ten million Baht, if there arises, whether such debt is due immediately or at a future time, a reasonable cause and prospect for the reorganisation of the debtor's business, the person under section 90/4 may file a petition with the Court for the business reorganisation.** **Section 90/4. Subject to section 90/5, the following persons are entitled to file a petition with the Court for the business reorganisation:** **(1) one creditor or several creditors altogether, with a definite amount of debt of not less than ten million Baht;** **(2) the debtor of the description under section 90/3;…**	**Reorganisation** **Section 90/3. When the debtor becomes insolvent and is indebted to one creditor or several creditors, whether such debt is due immediately or at a future time, and there arises a reasonable cause and prospect for the reorganisation of the debtor's business, the person under section 90/4 may file a petition with the Court for the business reorganisation.** **Section 90/4. Subject to section 90/5, the following persons are entitled to file a petition with the Court for the business reorganisation:** **(1) one creditor or several creditors;** **(2) the debtor of the description under section 90/3;…**

In addition, the thesis proposes that an amendment should be made to the *CCC* and the *PLC* in order to impose a specific duty on directors of a company to prevent insolvent trading when the company is factually insolvent or in the state of insolvency, and that if the directors contravene this proposed duty, they are personally liable to losses or damages for the debts incurred by the company's insolvency as stipulated in the new provisions specified in the *Bankruptcy Act 1940*. This amendment could strengthen the proposed provisions in ss 88/1-88/4 on directors' liabilities for insolvent trading under the *Bankruptcy Act 1940* by encouraging company directors to act responsibly and efficiently with a higher level of care and diligence in order to protect creditors' interests during the insolvency state.

V CONCLUSION

It has been argued that Thai law should be reformed in order to stop insolvent trading. The main reason is that the current Thai laws, whether the *CCC*, *PLA*, *SEA* or *Bankruptcy Act 1940*, are not effective in dealing with the problem: a company director has no specific duty when a company is in the state of insolvency or is insolvent.

This research has identified three main issues that are necessary to stop the problem of insolvent trading: the introduction of insolvent trading provisions into Thai legislation; Thai law has to define the meaning of a director whether *de facto*, *de jure* or shadow director; and the issue of an option to reorganise should be addressed.

It is suggested that relevant amendments should be made to the *Bankruptcy Act 1940*. However, only reforming the *Bankruptcy Act* may not be enough to achieve all that is needed to resolve the problem of insolvent trading. There are actions required of the SEC and there need to be provisions included that clarify two other matters for the court. These matters are, first, even though the *Bankruptcy Act 1940* determines that a company is to be verified by the balance sheet test, courts should consider using two tests, that is the cash flow and balance sheet tests, to properly verify the status of a company. Furthermore, the SEC should provide guidelines for directors, creditors and investors to alert and protect themselves from insolvent trading.

CHAPTER 7: CONCLUSION

I INTRODUCTION

Insolvency is an important issue as it can be an obstacle to economic growth in developing countries such as Thailand. As evidenced by the data from the Thai bankruptcy court, insolvency affects an enormous amount of assets in Thailand. An unavoidable problem concerning insolvency is the meltdown of companies. Company collapses may occur for many reasons, for example through fraud, recklessness, misconduct or simply through lack of knowledge of business practices on the part of directors. All these factors can lead to insolvent trading. This thesis has focussed on the insolvent trading problem and noted, with some surprise, that it is not mentioned as a cause of insolvency in Thai law.

As demonstrated by the *Pin Chakkaphak* case (described in Chapter 1), there is no specific law to prevent insolvent trading in Thailand, and so this situation persists. Thailand still does not have any specific provisions or measures to deal with the problem of insolvent trading, even though this problem can severely damage business sectors, creditors and economic growth.

Thus, this thesis focused on the insolvent trading problem, particularly with respect to making company directors personally liable, and in order to increase the protection offered to creditors as a result. This thesis has found that the insolvent trading problem is an issue of interest at both the domestic and international levels. At the international level, it was noted that the UNCITRAL Committee has provided legislative guidelines to help jurisdictions modernise and harmonise the laws and to prevent the insolvent trading problem. At the domestic level, the thesis examined four developed countries; that is, the UK, Australia, the US and Germany. Specific provisions or theoretical principles that these countries use to solve the insolvent trading problem have been adopted as recommendations to reform the Thai law.

In order to formulate essential recommendations, the thesis described the current Thai corporate regulatory system in Chapter 2. The thesis then, in Chapter 3, analysed and critiqued the current Thai corporate and bankruptcy laws to show that they do not

efficiently deal with the insolvent trading problem. Fundamentally, there are six main causes of insolvent trading in Thailand. In order to develop a model for reform, the thesis explored and critiqued the law and theoretical principles that deal with insolvent trading from the selected countries and the UNCITRAL guidelines. In doing so the thesis considered the strengths and weaknesses of the various provisions and recommendations. Chapters 4 and 5, thus, discussed the different definitions of a director, and specific duties required of directors to prevent insolvent trading. These Chapters also discussed the liabilities levied on directors; the defences available to directors and, further, provisions that act as an option for directors to work to avoid insolvency, one of which is to introduce a directors' duty not to engage in trade during, what has been referred to in this thesis as, the insolvent state.

The rationales and barriers to reforming Thai laws were set out in Chapter 6, which also included a set of recommended model provisions to prevent insolvent trading under Thai law. In particular, the thesis concluded that the Thai *Bankruptcy Act 1940* is the appropriate legislation to amend to accommodate the recommendations. This particular act was chosen as it regulates all types of companies, whether private or public. These recommendations and suggestions for the insolvent trading provisions apply to the Thai courts and state agencies, like the Securities and Exchange Commission.

The remaining sections of this chapter will report on the findings of the thesis and provide recommendations that respond to the research questions listed in Chapter 1. In doing so, some limitations to implementing these recommendations and some questions that will require further research will be discussed.

II RESPONSES AND RECOMMENDATIONS RELATING TO THE RESEARCH QUESTIONS

Drawing on the findings of this research, the following responses attempt to answer the research questions raised in Chapter 1.

1. How do the current Thai statutes deal with the problem of insolvent trading? Are the laws sufficiently efficient in terms of directors' personal liabilities and protection of creditors' interests?

This thesis studied the *Civil and Commercial Code*, the *Public Companies Act BE 2535* (1992), the *Securities and Exchange Act BE 2535* (1992) and the *Bankruptcy Act BE 2483* (1940) of Thailand, particularly with regard to the problem of insolvent trading. The findings show that the Thai corporate law and bankruptcy law are inefficient in protecting creditors' interests and those participating in business generally. Also, the current laws do not impose a positive duty on directors when a company is in the insolvent state. In other words, a company director is not liable when engaging in insolvent trading as there are no specific provisions to prevent such trading.

The thesis found that current Thai laws are ineffective in dealing with the insolvent trading problem for six main reasons:

The first problem relates to the separate legal entity principle. Thai courts are hesitant to pierce the corporate veil in order to penalise a company director. The principle of the corporate veil separates a legal entity and those who act as its directors and officers. In effect this principle protects the directors and officers from liability. This principle is applied strictly by Thai courts and consequently company directors or officers have a shield, even though their negligent actions have resulted in the company not being able to pay its debts to creditors.

Second, the thesis, found that under Thai corporate law, neither the *CCC* nor *PLC*, provide a definition of 'director'. This lack of definition of a director can lead to a shadow director, who is responsible for insolvent trading, avoiding liability for any damages incurred by the company.

Third is the problem of uncertainty in the matter of the standard of care of directors under Thai law. Courts' decisions and scholarly opinions reveal that the standard of care required of directors in controlling a company's business is applied variously. For instance, the standard of care of directors under the *CCC* may be verified depending on a number of factors, such as the size of the company and whether it is operated by a family;[939] and under the *PLC*. As Varayudej points out, s 85 does not clearly identify

[939] Ratanakorn, above n 135, 410.

a standard of care for business administration – a court has to interpret this section by using judicial discretion on a case-by-case basis.[940]

Fourth, this thesis has found that the directors' liabilities as set out under Thai law are inefficient and are not suitable for punishing directors and preventing insolvent trading. Also, there are very few remedies for those affected by insolvent trading. Therefore, it is recommended that the law includes liabilities for directors who operate a company while it is insolvent, and remedies for those affected. Furthermore, the state of insolvency is not mentioned in any Thai laws. This means that when a company is in the insolvent state, there is no specific duty imposed on directors to increase their level of care when conducting company business.

Lastly, there is no effective option under the *Bankruptcy Act 1940* for directors to attempt to address the company's financial state by utilising the reorganisation procedure. One significant obstacle is that the minimum amount of debt required by the law does not encourage creditors or debtors to seek to reorganise the company's business operations. The *Bankruptcy Act 1940* requires that there be at least a company debt of THB10 000 000 before a debtor can initiate the reorganisation procedure. That is, if a company is insolvent but has debts worth less than THB10 000 000, the reorganisation procedure will not be legally available to the company.

Thus in summary, the current Thai statutes do not efficiently regulate directors' personal liabilities, protection of creditors' interests and so on.

2. What are the advantages and disadvantages of insolvent trading provisions under various jurisdictions?

As noted in Chapter 1, it comes as no surprise that there is no perfect law or provision to prevent insolvent trading. Each suggested approach has its pros and cons. This thesis, in Chapters 4 and 5, has explained and critiqued the provisions and theoretical principles adopted by other countries that are relevant to the case of insolvent trading in terms of their advantages and disadvantages. Moreover, tables to compare the laws

[940] Varayudej, above n 13, 159.

and theoretical principles were provided to clearly explain the differences. For example, the meaning of director, tests to verify a company's financial status, and tests to verify directors' duty and liabilities were provided in Chapter 4. In addition, a table comparing the commencement of directors' duty for not engaging in insolvent trading in various jurisdictions was provided in Chapter 5.

Fundamentally, in the matter of the definition of director, the US and German laws do not present a clear definition of director, whereas the UK and Australian laws do. However, the disadvantage of the definition of director under UK law is that it is too broad and unclear. The advantage of the Australian definition of a director is that it is more precise than that of the UK. However, there is no difference in the meaning of shadow directors in UK and Australia, as discussed in Chapter 4.

Second, except for the US, statutory rules dealing with the problem of insolvent trading are provided in all selected countries. The disadvantage of the US provision is that the theory of fiduciary duty it employs has been applied variously in practice. However, unlike the other three countries examined in this thesis, the US's specific provisions specifically create a duty and liabilities for a director who fails to prevent his company from insolvent trading.

The details of specific laws in the diverse jurisdictions are different. For instance, evidence of the level of standards in managing a company are required to decide upon wrongful trading and insolvent trading under the UK and Australian laws respectively, whereas no specific standard is mentioned in the German law. The US does not refer to the test which applies to verify the standard of conduct required of a director when a company is in the state of insolvency. This makes the UK and Australian laws more desirable models upon which to reform Thai laws. They contain a clear standard incorporating both subjective and objective tests to verify whether a director's execution of his tasks is appropriate.

It is notable that the advantage of utilising specific provisions or the fiduciary duty to prevent insolvent trading leads to encouraging the lifting of the corporate veil. This can

be an incentive for courts to impose liabilities on company directors without hesitation. This thesis, therefore, explored the idea of setting a time at which a director should have a duty to prevent insolvent trading for Thailand. The details of state of insolvency were analysed in Chapter 5.

The thesis examined liabilities, remedies and defences for insolvent trading in Chapter 4. It concluded that no country's provisions are appropriate to guide Thailand's reform. Thus, the thesis analysed the differences between the various laws or concepts used by those other countries, and also pointed out their advantages and disadvantages. The thesis also aimed to extract the advantageous aspects of the laws of other countries which might be suitable models for reform of Thailand's laws in order to prevent insolvent trading and to protect creditors' assets and business sectors. These are set out in Chapter 4 and 5.

3. What legislative models adopted in the United Kingdom, Australia, the United States and Germany or the UNCITRAL guidelines would be appropriate for Thailand's reform of its current legislation in order to impose on company directors a duty to prevent insolvent trading?

In Chapter 6, a legislative model for insolvent trading for Thailand was suggested by selecting, adopting and developing provisions drawn from appropriate parts of foreign laws and the *UNCITRAL Legislative Guide*. For example, Thailand needs specific provisions to deal with the problem of insolvent trading, similar to those of the guidelines of UNICITRAL, UK, Australia and Germany. This thesis suggests that the Australian definition of 'director' be adopted, whereas the meaning of shadow director can be taken from the UK or Australian laws because they are similar. In regard to tests to verify a director's execution of his duties, both subjective and objective tests are necessary. These tests have been drawn from the UK and Australian laws. In addition, the time when insolvent trading begins needs to be specified. All foreign countries and the UNCITRAL guidelines indicated the starting point when a director has a duty not to engage in insolvent trading. The significant time was when a company is in the

insolvent state. Thus, new insolvent trading provisions are recommended that focus on the time when a company is in the insolvent state.

The defences under the Australian law are judged to be the most suitable to be adopted into Thai laws. This decision was made after a process of comparing and contrasting the advantages and disadvantages of the defences of all of the countries examined.

Also, the researcher considered the liabilities imposed on directors in various countries, and considered them in relation to the Thai context. This thesis also suggests that the *Bankruptcy Act 1940* is the law to which should be added insolvent trading provisions and that the reorganisation provisions should be amended. The model insolvent trading provisions proposed by this thesis are recommended as mentioned in Chapter 6.

III RESEARCH OUTCOMES

The research outlines the provisions of a number of other countries and the UNCITRAL guidelines that seek to prevent insolvent trading. Using doctrinal legal analysis and comparative legal research, the thesis evaluates those provisions. This exploration will be of benefit as a primary basis for reforming Thai law in the future.

The thesis also identifies a number of inefficiencies in the current Thai law to deal with the problem of insolvent trading. To do so, the thesis analysed and critiqued the provisions, highlighting how some rules are weak in the matter of preventing insolvent trading and protecting creditors from such reckless trading. The result of the ineffectiveness provided a reason for supporting new measures for reform of Thailand's law.

The obstacles to reforming were explored. The study not only tries to point out the recommended model law, but also reveals the problems which may affect the process of reform. There are three main obstacles, as explained in Chapter 6: delays in amending the legislation; intervention by the senate or influential persons; and negative comments by legal actors like judges and prosecutors who lack sufficient knowledge, particularly in the case of securities law and insolvent trading. These

obstacles show that the insolvent trading problem in Thailand, which affects the economic growth of the country, occurs not only because the laws are out-of-date or do not have specific provisions for preventing insolvent trading, but are subject to corruption. The foremost contribution of the study is to propose model insolvent trading provisions which can be applied to prevent such reckless trading. These provisions can potentially promote Thailand's economic development. By reforming Thailand's laws to impose a duty on directors not to engage in insolvent trading, foreign investors, minority shareholders, stock markets and creditors will be assured that there is an effective legislative framework in Thailand. Moreover, insolvent trading will be much reduced. Thus, if the Thai business sector is strengthened by effective laws, it will encourage foreign investors to invest in Thailand. In other words, the contribution of the study is a chance to protect many creditors from being deceived by insolvent trading, and enhancing investors' confidence in the efficiency of the securities market in Thailand. This research will, thus, be of benefit to Thai and foreign creditors and investors who would like to do business in Thailand.

IV SUGGESTIONS FOR FUTURE RESEARCH

The study of company directors' personal liability for insolvent trading in Thailand raises a number of opportunities for future research. These can be categorised into three groups. Firstly, future research could be conducted by using the qualitative research method. This method empowers the researcher to gather first-hand understandings, whether beliefs, ideas or the way of seeing future problems from interviewees. Therefore, the results of future research using this approach may give some different perspectives from those used in this thesis.

Secondly, future research can build upon the findings of this study. For example, some questions raised by the study are: if the minimum debt required for reorganisation under the Thai *Bankruptcy Act 1940* was deleted, how would this affect the bankruptcy court? Would this encourage the use of the reorganisation procedure? What are the advantages and disadvantages of the law without a minimum of debt required? Moreover, the issue of the tests which are used to verify company insolvency is

interesting. Does Thai law need to provide the cash flow test to indicate an insolvent company? A measure to reduce opportunities for corruption, and which can bring good corporate governance into Thai company business practice, is also an interesting issue worth exploring in further research.

Lastly, at the international and regional level, particularly for the ASEAN Economic Community (AEC), the insolvent trading problem could be of concern to many countries. Is it necessary to harmonise the laws to prevent insolvent trading in ASEAN, like the UNCITRAL committee aims to do for the global economy? What institution should have a duty to provide the guidelines for the AEC in order to develop the corporate and insolvency laws for good corporate governance?

In summary, this author strongly believe that insolvent trading provisions are needed whether at domestic, regional and international levels. These provisions can be used as a shield to protect creditors' interests, and also as a measure to remind and increase the awareness of company directors in managing a company that is insolvent or close to insolvency.

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