

LEGAL ISSUES ON CREDITORS' RIGHTS AND PROTECTIONS IN SINGLE MEMBER COMPANIES*

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Abstract

Single member company is a type of business organisations which can be established by a sole member who shall have a limited liability not exceeding the contribution. Since single member company has a separate legal entity, it shall have its own rights and liabilities. This hybrid characteristic is problematic for creditors who engage in business transactions with single member companies because they fear that their rights will be affected. Since nowadays, there is an attempt to recognise the concept of single member company in Thai jurisdiction, the key to the success of the new legislation is that the law must balance between single member companies' benefit and creditors' rights for the highest mutual interest.

Keywords: Single member companies, one-man companies, creditors' rights and protections

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บทคัดย่อ

บริษัทจำกัดคนเดีวเป็นองค์กรธุรกิจที่สามารถจัดตั้งได้โดยบุคคลเพียงคนเดียวซึ่งมีความรับผิดชอบจำกัดไม่เกินจำนวนทรัพย์สินที่นำมาลงทุน บริษัทจำกัดคนเดีวมีสิทธิและความรับผิดชอบของตนเองเนื่องจากมีสภาพบุคคลแตกต่างหากจากผู้ก่อตั้ง คุณลักษณะพิเศษนี้ก่อให้เกิดปัญหาต่อเจ้าหน้าที่ของบริษัทว่าสิทธิของเจ้าหน้าที่นั้นอาจถูกกระทบกระเทือน ปัจจุบันหน่วยงานที่เกี่ยวข้องอยู่ในระหว่างดำเนินการร่างกฎหมายเพื่อรองรับการจัดตั้งบริษัทจำกัดคนเดีวในประเทศไทย การคำนึงถึงประโยชน์ของบริษัทจำกัดคนเดีวควบคู่ไปกับสิทธิของเจ้าหน้าที่จึงเป็นสิ่งสำคัญที่จะทำให้กฎหมายฉบับนี้บรรลุวัตถุประสงค์

คำสำคัญ บริษัทจำกัดคนเดีว, นิติบุคคลคนเดีว, สิทธิและการคุ้มครองเจ้าหน้าที่

Introduction

Businesses grow rapidly in the digitalisation age because of technology. The trend of the business model has changed and there are many small enterprises (SMEs) operated by a sole owner. Various small enterprises can be totally managed by a sole owner. Statistics issued by the Thai government show that the majority of enterprises incorporated in the country are small or medium-sized.¹ There are about 200,000 incorporated companies where their majority shares, i.e. more than 50 percent are held by just one person.² Therefore, there should be a simplified corporate form that is more appropriate for small enterprises.³ However, the current Thai law i.e. the Civil and Commercial Code (CCC) is still inconsistent with this new trend of business. The most significant problem is that at least three shareholders are required to incorporate a private limited company and the process of establishing a company is time-consuming and costly. After the incorporation, there are many obligations with which the company must comply under this law.

In fact, single member company is not a new concept. Many sole proprietors who want to limit their liability in order to reduce their risk in operating the business incorporate a company by providing a tiny number of shares for nominees to meet the minimum requirement of the number of shareholders. These nominees are usually people who have a close relationship with the proprietor. This kind of enterprise could be called a “single member company de facto” which is deemed to be a legitimate business organisation. Consequently, various jurisdictions can find no reason to stipulate the minimum number of shareholders. The requirement of a minimum number of shareholders has become less significant due to the development of the concept related to company law. Thailand is no exception and an attempt is currently being made to legislate a new law to adopt the concept of a single member company in Thai jurisdiction as appeared in the Draft Law on

¹ The Office of Small and Medium Enterprise Promotion (OSMEP), the Strategy Plan of The Office of Small and Medium Enterprise Promotion no.3 B.E. 2555 – 2559 (2011) Bor-1 (สำนักงานส่งเสริมวิสาหกิจขนาดกลางและขนาดย่อม (สสว.), “แผนส่งเสริมวิสาหกิจขนาดกลางและขนาดย่อม ฉบับที่ 3 พ.ศ. 2555-2559” (2554) บ-1)

² Noppadon Pakornnimiddee, *the Advantages and Disadvantages of the Formation of a One-Man Company in Thailand* (School of Law, Sripatum University 2016) 1 (นพดล ปกรณ์นิมิตดี, รายงานการวิจัยเรื่องข้อดีและข้อเสียการจัดตั้งบริษัทจำกัดที่มีผู้ถือหุ้นคนเดียวในประเทศไทย (คณะนิติศาสตร์ มหาวิทยาลัยศรีปทุม 2559) 1)

³ Legal and Development Research Institute of Chulalongkorn University, *the Research on Recognition of Single Member Companies, Final Report* (11th September, 2015) 48 (ศูนย์วิจัยกฎหมายและการพัฒนา จุฬาลงกรณ์มหาวิทยาลัย, โครงการศึกษากฎหมายเพื่อรองรับการจัดตั้งนิติบุคคลโดยบุคคลคนเดียว รายงานการศึกษาลงบสมบรูณ์ (11 กันยายน 2558) 48)

Single Member Companies Act B.E..., which was approved by the Council of Ministers on the 24th January, 2017.

The consequence of incorporating companies is that the legal entity of the company will be separated from the sole member. There are several matters to be considered due to the adoption of this concept from a legal perspective. Based on the hybrid characteristic of single member companies i.e. while they are similar to those of sole proprietorships, they consist of a single person who is able to limit his liability to the extent of his personal funds like members of multi-member companies. This characteristic is problematic for creditors who engage in business transactions with single member companies because they fear that their rights will be affected. Creditors may have to bear a higher level of risk. Since there is only one member who has the full power to control the company, it is more likely to fail due to the lack of efficient management and expertise. Moreover, since company is funded by a sole person, it is exposed to the risk that it may be undercapitalised or unable to access loans from banks or financial institutions for its business activities due to less creditability. As a result, the company may not have sufficient funds to repay its debts. The other controversial aspect of single member companies is trust. Since it is less formal, a single person may easily incorporate a single member company in bad faith as a corporate veil for the purpose of evading liability against creditors. A sole member may engage in unfair or illegal conduct without being controlled by other shareholders.⁴ Thus, it could be said that the special characteristic of a single member company could expose creditors who engage in business transactions with it to a greater risk.

Based on the realisation of this indisputable problem, the appropriate creditors' rights and protections are also undeniable to effectively recognise a single member company. The focus of this thesis will be the legal issues related to the balance between the benefits of single member companies and creditors' rights and protections for the best mutual interest. Some traditional provisions may be exempted in order to facilitate the management of single member companies due to their unique characteristic, while some specific provisions are required to provide creditors with sufficient protection.

Creditors' Rights and Protections in Single Member Companies under Thai and UK Law

From the study on Thai Draft Law on Single Member Companies Act B.E... (Draft law), the Civil and Commercial Code (CCC), Thai Bankruptcy Act B.E. 2483 and the law under UK jurisdiction namely: Companies Act 2006 (CA),

⁴ ibid 37

Insolvency Act 1986 (IA) and Company Directors Disqualification Act 1986 (CDDA), there are several relevant interesting legal issues which can be categorised as follows:

1. Members' Qualifications

Similar to other types of business organisations, the UK law simply imposes the same regulations regarding the existence and management of other types of business organisation to single member companies so long as they are not in conflict with the characteristic of having a sole member.⁵ This issue is very distinguished from Thai draft law where there are several conditions to set up a single member company. The member must be a Thai natural person who has full competence and has not been convicted bankruptcy, fraud or found guilty of any criminal offences related to fraud. There are also several grounds of winding up of single member companies under Thai draft law, i.e. the death, bankruptcy or incapacity of the member. Moreover, each person shall set up only one single member company in order to prevent the undercapitalisation problem.⁶ These qualifications obviously reflect the concern regarding creditors' rights and protections in single member companies. However, since single member companies are normally closely-held companies and their conduct usually only affects a few relevant parties, some requirements may be unnecessary for incorporation of a single member company.

2. Change of Members

Further from the above mentioned issue, the existence of single member companies under UK law is not relied on sole members. Their shares are transferable in accordance with the company's Articles.⁷ In the event of the death of the sole member, the heir shall be responsible for both rights and duties in accordance with the law of succession.⁸ Besides, single member companies can only be transformed into multi-member companies by being entered in the register of company members.⁹

⁵ CA s. 38

⁶ The Draft Law on Single Member Companies Act B.E...., s. 3, 9, 11 and s. 38(1)-(2)

⁷ CA s. 544(1)

⁸ Legal and Development Research Institute of Chulalongkorn University (n 3) 143

⁹ CA s. 123

Different from UK law, a company under Thai draft law can restructure its investment by seeking other investors to meet the minimum requirement of the incorporation of limited companies (three shareholders under the current CCC). This provision imposes the duty on the company to notify the creditors before the transformation and creditors are entitled to object to it.¹⁰ Nevertheless, since there is no explicit provision which allows the voluntary transfer of the company to a new investor, I may assume that single member companies under this draft cannot be transferred to a new owner. On the one hand, this prohibition could obstruct the growth of the business. However, it is one of the mechanisms which provides protection to creditors because there is a close bond between the sole member and his single member company. The qualifications of the members are an important factor in single member companies. The change of member could increase the risk of inability to enforce the repayment of debt by creditors. Finally, in the event that the heir intends to keep operating the business in the event of the death of the member, the company could devolve to the heir in accordance with the CCC.¹¹ It could be called the transfer of company by law. On the one hand, allowing the heir to continue the business will enhance its consistency. However, similar to the voluntary transfer, this change also affects the creditors' position. Therefore, from my view, the transfer of company by law should not be allowed.

3. Directors' Qualifications

Directors are the persons who have the duty to manage the company's day-to-day business; therefore, their conduct does not only affect the members, but also affects other relevant persons. Under the UK law, there are some requirements on directors' qualifications.¹² Moreover, the court may disqualify a person from holding the office of director on several grounds; for instance, on conviction for an indictable offence, persistent breach of companies legislation, fraudulent trading and unfitness management.¹³ Under Thai draft law, parallel to the members' qualifications, the directors must have full competence and also must not have been convicted or found guilty of certain offences related to fraud.¹⁴ Therefore, we may conclude that both jurisdictions impose several similar directors' qualifications and prohibit the disqualified persons to hold the office of director.

¹⁰ The Draft Law on Single Member Companies Act B.E...., s. 33

¹¹ The Draft Law on Single Member Companies Act B.E...., s. 38(1)

¹² CA s. 155, 157

¹³ CDDA

¹⁴ The Draft Law on Single Member Companies Act B.E...., s. 17

4. Directors' Specific Duties

Following from the above issue, since directors' conduct does not only affect members, it also affects relevant parties. UK law explicitly emphasises directors' duty to consider the interest of creditors which does not exist in Thai jurisdiction.¹⁵ Based on this provision, the other specific law that imposes directors' duties to creditors is the insolvency law. Directors, including other officers, may be penalised for malpractice in the course of winding up. Any person who operates the business to defraud the creditors shall be liable to make a contribution to the company and also be charged with a criminal offence.¹⁶ Besides, the directors could be liable for making a contribution to the company for wrongful trading in the event that there is no prospect of avoiding insolvent liquidation.¹⁷ The interesting issue is that whether or not there is similar mechanism under Thai jurisdiction. From the study, Thai law fails to deal with several circumstances which are detrimental to creditors' rights.

Directors are not liable for any damage occurred due to risky management. Thai law does not impose liability on directors who conduct business activities after they realised that the company could not avoid insolvent liquidation. Even though the directors know the said fact, they have no duty to inform creditors of the company's poor financial status. Discovering this is deemed to be the creditors' responsibility.¹⁸ Therefore, there is an academic opinion that Thai law should recognise these principles in order to promote creditors' rights and protections.¹⁹

5. Disregard of Corporate Entity

Under UK jurisdiction, there have been some cases of single member companies to which the concept of piercing the corporate veil was applied; for example, the company was initially established for fraudulent purposes, was undercapitalised or the assets had been disposed of so that nothing was left to repay the debt to creditors.²⁰ In these cases, the court shall use its discretion to decide whether to pierce the corporate veil in order to make members personally liable for company's debt. Although this principle is not specifically imposed on a single member company, there is more potential that the doctrine of piercing the corporate veil shall be applied to a single member company due to the characteristic that it is absolutely controlled by a sole person who could easily be found guilty of misconduct. Under Thai jurisdiction, this principle specifically appears only in s. 44

¹⁵ CA s. 172

¹⁶ IA s. 213; CA s. 993

¹⁷ IA s. 214

¹⁸ *ibid* 102

¹⁹ *ibid* (3)-(4)

²⁰ Legal and Development Research Institute of Chulalongkorn University (n 3) 30

of the Consumer Protection Act, in which the court may order shareholders and other controllers such as directors to be liable for the company's debt towards consumers. However, no general rule exists in Thai law. Therefore, this concept seems to have been applied less explicitly compared to the UK jurisdiction.

6. Share Capital

The member of a single member company in both jurisdictions shall generally have the duty to pay a contribution to the company. Under UK law, the member may contribute either money or something that is worth money to the company.²¹ This means that labour can be appraised and contributed to the company's assets. Under the current Thai draft law, members may contribute capital in the form of money or assets, but not in the form of labour.²² This restriction is one of the provisions that reflects the concern about creditor protection. It would be difficult to appraise the value of labour; therefore, if a contribution by labour was allowed, it is likely that single member companies would be undercapitalised in order to limit the liability of the member. In my opinion, this regulation however seems to be inappropriate. Single member companies are designed to be suitable for small traders. In fact, it is common in today's business that these traders may not have any valuable asset to contribute to the company; however, they have a specialised skill or know-how to operate a business and earn an income. Therefore, they should be allowed to contribute by their labour.

7. Capital Maintenance

Since company's capital is deemed a security for creditors, i.e. in the event of default, creditors will be able to impose the repayment of debt from the company's capital contributed by members. Generally speaking, both jurisdictions impose similar mechanisms on this issue as follows. First, the minimum capital requirement some jurisdictions specify the minimum capital requirement in single member companies based on concern that they could be undercapitalised. However, there is no such requirement for private limited companies in both UK and Thai law, since the appropriate amount of capital depends on each business. Thus, it is unreasonable for the law to specify a fixed amount of capital. Second, the provision on reduction of capital is another approach to maintain the company's capital. Under UK law, companies must comply with several procedures before the reduction of capital; for instance, solvency statement made by directors, the confirmation by the court and creditors' right of objection.²³ Similar to UK law, the Thai draft law also

²¹ CA s. 582(1)

²² The Draft Law on Single Member Companies Act B.E...., s. 3

²³ CA s. 641-653

imposes several procedures on the reduction of capital which reflect the same concern on creditors' rights.²⁴ Finally, the regulation on the distribution of dividend is another approach to maintain the total assets of the company which will be advantageous to the amount claimable by creditors. Both jurisdictions impose several procedures on this issue. Creditors are entitled to claim for compensation for unlawful distribution. Members and relevant officers shall be liable to make contribution in such event.²⁵

8. Mandatory Disclosure

Due to the characteristic that a single member company consists of a sole member who has limited liability and this member has absolute power to control the business, this member could easily make decisions by himself that affects the rights of other relevant parties. Therefore, the mandatory disclosure of information and documents is considered to be one of the most significant approaches to protect creditors' rights. First, there is a requirement to register important information of single member companies in both jurisdictions.²⁶ Besides, the mandatory disclosure of a company's accounts and reports is another important mechanism to secure creditors' rights and protections. These documents must be prepared and examined accurately as stipulated by the law. Therefore, third parties will be able to access these documents to determine the financial status of the company and be able to estimate the risk of engaging in business transactions with it. The study found that both jurisdictions have imposed several duties on the accounts and reports.²⁷

Nevertheless, the interesting point is that under UK law, small companies shall be exempted from some duties such as preparing a strategic report, directors' report and examination of the accounts by an auditor in order to reduce the difficulty in operating a small business. If single member companies are qualified as small companies, they will be exempted from several duties. From my point of view, this kind of provisions should be introduced into Thai draft law in order to impose appropriate duties considering the risk that could be created by each company.

Written document is an important evidence to express the members' internal intentions to the third persons. Since there is no general meeting in single member companies, a record of any decisions made by the sole member should be

²⁴ The Draft Law on Single Member Companies Act B.E...., s. 32

²⁵ CA Part 23; The Draft Law on Single Member Companies Act B.E...., s. 28-30 and 52

²⁶ CA s. 123; The Draft Law on Single Member Companies Act B.E...., s. 5-7, 12-13, 48-49

²⁷ CA Part 15; The Draft Law on Single Member Companies Act B.E...., s. 23-24

provided to the company.²⁸ Besides, apart from the ordinary course of business, the contract between the company and its sole member shall be made in writing.²⁹ These are the only provisions under UK law which imposes duties specifically on single member companies. Notwithstanding, there is no similar provision existed in the draft law. Therefore, I suggest that this provision is appropriate to introduce into Thai draft law in order to enhance creditors' rights and protections in single member companies.³⁰

9. Adjustment of Transactions

Some vulnerable transactions engaged in by the company could affect the amount claimable by creditors. There are mechanisms to adjust the company's remaining assets in order to maximise the value of these transactions. Different from imposing liability on relevant parties, these provisions aim to provide remedies for damage, i.e. to restore the position of the company or cancel vulnerable transactions. Both jurisdictions provide mechanisms to restore the position of the company or cancel the transactions at an undervalue or giving preferences to particular creditors.³¹ Even though there are some different procedures and requirements, we will find that Thai law has provided remedies similar to UK law.

10. Restriction on Re-use of Company Names

The re-use of the names of companies that underwent insolvent liquidation by the directors or shadow directors is also prohibited for a certain period under UK law. This provision reflects the concern regarding a situation in which the director allows the insolvent company to be liquidated for the purpose of evading his obligation and then establishes a new company and operates a similar business with similar resources, which is called the phoenix syndrome.³² Single member companies tend to be small businesses which are inclined to have a high potential of failure because of a lack of expertise. Therefore, this mechanism could play an important role in preventing the incorporation of a new company in order to evade the debt owed to creditors.

Conclusions

²⁸ CA s. 357

²⁹ CA s. 231

³⁰ Legal and Development Research Institute of Chulalongkorn University 124 (n 3) 134-135

³¹ IA s. 238-241 and 423-425; CCC s. 237; Thai Bankruptcy Act B.E. 2483, s. 113-115 and 90/40-90/41

³² IA s. 216

From the study, I found several issues which are relevant to creditors' rights and protections in single member companies. Some of mechanisms under Thai jurisdiction are similar to UK law; for instance, the provisions on capital maintenance and adjustment of transactions. However, due to the idea that the existence of single member companies is relied on their sole members, Thai draft law imposes several restrictions on members' qualifications which may cause difficulty in business. Moreover, there are some mechanisms in UK law which could be introduced into the Thai counterpart in order to promote the creditors' rights and protections in single member companies; namely, the provisions on the decisions made by the sole members and the contract between the company and sole member shall be made in writing, the duties regarding the preparation of company's accounts and reports should be determined by the size of single member companies, directors should have specific duties to be concerned with the interest of creditors in the event of insolvency, and restriction on re-use of the insolvent company names.

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