

PROTECTION OF NON-ADJUSTING CREDITORS OF
PRIVATE LIMITED COMPANIES IN THAILAND*

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Abstract

This article analyses the legal framework for protecting non-adjusting creditors of private limited companies in Thailand. Non-adjusting creditors are a subcategory of creditors, not specifically recognised by law, who are unable to negotiate contractual or proprietary protections and are thus vulnerable to potentially abusive actions of the debtor company. Using the Enlightened Shareholder Value model of corporate governance, the legal regime is evaluated across rules relating to legal capital, challenging transactions, directors' duties and obligations to preserve creditors' interests, and shareholder liability. The article also performs a comparative analysis with English and German law, which influenced Thai law at the time of its adoption, to highlight Thai law's path of development and characteristic approach. The article makes six recommendations to align Thai law with the ESV normative model, including the establishment of a regime of public enforcement by way of administrative sanctions and a director disqualification regime to protect non-adjusting creditors.

Keywords: Company law, Creditor protection, Legal capital, Directors' duties, Shareholder liability, Director disqualification

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1. Introduction

When a business fails, the losses must fall on someone. In the case of a business operated by a private limited company, the company's directors and shareholders are protected by legal rules and doctrines conferring limited liability on the shareholders and recognising the separate legal personality of the company.¹ Instead, if the business fails and the company enters bankruptcy, the losses will fall on the company's creditors. However, the creditors do not all bear the losses equally.

1.1 Non-adjusting creditors and their vulnerability

Law and legal doctrine generally recognises two categories of creditors: secured creditors and unsecured creditors. The former are creditors that have procured the grant of a proprietary interest in the assets of the debtor company. If the debtor fails to repay, a secured creditor may enforce security and effect the sale of the asset to recover its debts. Importantly, the secured creditor need not share the proceeds of the sale with any other creditors; the asset does not form part of the debtor's estate in bankruptcy. The security interest attaches to the property, giving the secured creditor a large degree of protection and control.

Into the other conceptual group – 'unsecured creditors' – are placed all creditors who have not attained a security interest in the debtor's assets. They must typically bring claims to recover their debts, *pari passu*, in bankruptcy proceedings against a limited company whose business has failed. However, not all unsecured creditors are in the same position as regards the risks they take in the extension of credit.

Although further distinctions are not specifically recognised in the law or, generally, in legal doctrine, economics literature has long acknowledged further subcategories of unsecured creditors.² The first subcategory is formed by the distinction between adjusting creditors and non-adjusting creditors. The former are able to negotiate the terms on which they extend credit and may thus achieve better protection. An example would be a powerful trade creditor who supplies goods on credit but, in return, requires a guarantee from the debtor's parent company, or a letter of credit or bank guarantee. By contrast, a non-adjusting creditor – for example, a small trade creditor supplying to a powerful purchaser, such as a small supplier to a large supermarket chain – must supply on the *debtor's* preferred terms. With no realistic prospect of negotiation, the creditor only has the choice to either accept the terms or decide not to supply. A further distinction is made between voluntary and involuntary creditors. The former agree to become creditors, even if on unfavourable terms, whereas the latter become creditors without their consent. A classic example is a tort victim, who is owed payment of compensation by the company and is a creditor until it is paid.

¹ Sections 1015 and 1096 of the Thai Civil and Commercial Code ("CCC")

² Lucian Arye Bebchuk and Jesse M Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1995) 105 Yale Law Journal 857, 880–891.

There are economic benefits which come from a legal system's recognition of protections for shareholders, directors, and secured creditors. The benefits for the economy of the fundamental company law concepts of limited liability and separate personality are familiar to law and economics literature.³ The law's recognition of the distinction between secured and unsecured creditors, and its acknowledgement of other contractual protections, allows for flexibility and negotiation in the terms of credit, resulting in more efficient lending.⁴ Indeed, some unsecured and non-adjusting creditors may purposefully adopt this status to negotiate a greater return for accepting higher risk. Therefore, this article does not attempt to argue that non-adjusting creditors should be repaid in all circumstances, or in priority to secured creditors. Rather, it attempts to investigate whether non-adjusting creditors are left exposed to abuse *following* the extension of their credit, resulting in a lower recovery than ought to be the case, and, if so, whether the law can play a part in preventing this.

It is to the behaviour of the debtor company, prior to formal bankruptcy,⁵ that the focus of this article's discussion must move. There are incentives, well-recognised in economics literature,⁶ for managers and shareholders to engage in activity which harms the prospect of non-adjusting creditors to recover their debts. This behaviour may be put into three categories: asset dilution (the transfer of assets from the company to the shareholders or third parties), asset substitution (increasing the risk profile of the company in a search for higher profits), and debt dilution (taking on additional debt, which also increases the risk of business failure). These types of behaviour either reduce the assets of the company, against which creditors could otherwise claim, or increase the risk of business failure as managers and shareholders attempt to essentially gamble their way out of a difficult financial situation.

The incentives to engage in this behaviour are particularly acute in the case of a failing business where there is close connection or overlap between the shareholders and directors of a company (typically the case in private, rather than public, limited companies).⁷ The

³ Ben Pettet, 'Limited Liability—A Principle for the 21st Century?' (1995) 48 *Current Legal Problems* 125; Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 *The University of Chicago Law Review* 89; Paul Halpern, Michael Trebilcock and Stuart Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 *The University of Toronto Law Journal* 117.

⁴ E.g. Bebchuck and Fried (n 2).

⁵ Typically, due to the costs of insolvency processes, unsecured creditors make no recovery from the bankruptcy process. World Bank, *Doing Business 2020: Thailand* <<https://www.doingbusiness.org/content/dam/doingBusiness/country/t/thailand/THA.pdf>> accessed 15 February 2023.

⁶ Paul Davies, *Introduction to Company Law* (2nd edn, Oxford University Press 2010) 34; Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 5; Christopher Bruner, 'The Corporation's Intrinsic Attributes' in Barnali Choudhury and Martin Petrin (eds), *Understanding the Company: Corporate Governance and Theory* (Cambridge University Press 2017).

⁷ Davis (n 6) 78.

resulting losses fall first and foremost on non-adjusting creditors, due to their lack of proprietary or contractual protection and their low rank in the order of recoveries in bankruptcy.⁸

1.2 Evaluating the law’s protection of non-adjusting creditors

The extent to which behaviour should be considered ‘abusive’ to non-adjusting creditors, or resulting in recovery lower than ‘ought’ to be the case, must rest on principled foundations. This article adopts a normative approach to this analysis, drawing on the field of corporate governance scholarship, which is concerned with relationships between different groups within and concerning companies. The normative model used is the enlightened shareholder value (‘ESV’)⁹ model of corporate governance, which has been adopted in Thailand as best practice for listed public limited companies by way of the Corporate Governance Code 2017 (‘CG2017’).¹⁰ Although the CG2017 is not compulsory – it uses an ‘apply or explain’ concept for implementation¹¹ – its adoption by the National Corporate Governance Committee, chaired by the Prime Minister, signals that this is acknowledged by policymakers to be the best practice approach for large listed companies. It is arguably appropriate to extend this normative approach to private limited companies, given their larger impact on the economy,¹² and to create consistency across business forms and promote consistent norms across the business landscape.

Under the ESV normative model, the interests of all groups who are impacted by the company’s business decisions should be taken into account when those decisions are made. However, the principle to be used when trading-off the requirements of the different interest groups is the maximization of long-term shareholder value. This is justified by the idea that the shareholders are the ‘residual claimants’ to the firm’s assets: the group entitled to whatever is left once payments with higher priority, such as creditors’ claims, have been met.¹³

A legal system’s approach to the protection of non-adjusting creditors may therefore be evaluated using the following principles:

⁸ Section 130 of the Bankruptcy Act BE 2483 (“BA”).

⁹ See Michael C Jensen, ‘Value Maximization, Stakeholder Theory, and the Corporate Objective Function’ (2001) 14 *Journal of Applied Corporate Finance* 8.

¹⁰ ‘Corporate Governance Code 2017’ <<https://www.sec.or.th/cgthailand/en/pages/cgcode/cgcodeintroduction.aspx>> accessed 14 February 2023.

¹¹ *ibid*, 3.2.

¹² Private limited companies comprise vastly the largest number of firms established for business in Thailand and carry the largest share of invested capital of any juristic business form: <https://www.dbd.go.th/download/document_file/Statistic/2565/H26/H26_202206.pdf> accessed 11 November 2022.

¹³ This is aligned to justifications based on Agency Theory which builds on famous insights of Ronald Coase: see Ronald H Coase, ‘The Nature of the Firm’ (1937) 4 *Economica* 386.

1. First, legal strategies may be implemented to **ensure that shareholders maintain their status as residual claimants only**, and do not generate returns in priority to creditors. This supports preventing asset dilution.

2. Second, the law may justifiably address a situation where there is little prospect of a firm returning to profitability. In such circumstances, shareholders effectively are no longer residual claimants since they have little prospects of recovering any value. Where this is the case, the creditors become the residual claimants. This conceptually justifies, for example, rules of bankruptcy law which put creditors in effective control of a company, or which otherwise **shift the objectives of the company to operating in creditors' interests where they become the residual claimants**.

3. Under ESV, a conflict between different interests is resolved by considering what brings most value to shareholders in the long term. Asset substitution and debt dilution enhance returns for the shareholders in the short term, while prejudicing the stability of the company in the long term and the prospect of repayment of creditors. Therefore, a legal environment **which restricts the ability of companies to engage in asset substitution and debt dilution to benefit shareholders in the short term** is normatively justified under ESV.

On this basis, this article conducts an evaluation of Thailand's approach to the protection of non-adjusting creditors using the ESV normative model of corporate governance. However, this article also attempts to make recommendations for improvements to Thai law in this area. To do so, it conducts a comparative exercise against two legal systems which fundamentally influenced the development of Thai company law: English law and German law.¹⁴ The purpose of the comparative exercise is to highlight Thai law's path of development. It is argued that recommendations for legal change may be most effective where they are nuanced, shaped to fit with the legal system's path of development as closely as possible.

This article will proceed as follows. Sections 2 will analyse the protections afforded to non-adjusting creditors by Thai law, which are divided into four categories: legal capital rules, challenging transactions, directors' duties and obligations to preserve creditors' interests, and shareholder liability. For each category, Thai law is compared to English and German law.

¹⁴ The influence of German law on the CCC is well documented: e.g. Department of Legal Studies in Society, Philosophy and History, *Transcript of Interview with Phraya Manavarajasevi (Plod Wichiar Na Songkla)* (Winyuchon Publication House 2014) 3–4, 28–30 (Thai language); Preedee Kasemsup, 'Reception of Law in Thailand-A Buddhist Society' in Masaj Chiba (ed), *Asian Indigenous Law: In Interaction with Received Law* (KPI 1986) 293. English law is also recognised as having been particularly influential in the fields of company law and bankruptcy law: e.g. Ministry of Justice Thailand and René Guyon, *L'Oeuvre de codification au Siam* (Imprimerie Nationale 1919) 20–21 (French language); Faculty of Law, Thammasat University (Prof. Sahaton Ratthanapajitr et al), 'Research Report Concerning Project to Improve the Enforcement of Bankruptcy Cases in accordance with International Standards' (Thai language).

Section 3 summarises recommendations for improvement of Thai law, based on the evaluation and comparative exercise performed in the earlier sections. Section 4 concludes.

2. Thai law protecting non-adjusting creditors

Thai legal rules conferring protection on non-adjusting creditors, through constraints placed on the activities of directors and shareholders,¹⁵ may be divided into four categories along the lines of different groups who are connected to the debtor company. The first category is ‘legal capital rules’, which concern the capital structure of the debtor company, controlling the way in which capital is invested and returned to shareholders (thereby becoming unavailable to creditors). The second category is ‘challenging transactions’: rules of law allowing creditors or insolvency office holders to bring a claim to reverse transactions which have resulted in the inappropriate transfer of value away from the company. The third category is ‘directors’ duties and obligations to preserve creditors’ interests’, which may require the debtor’s directors to act in the interests of creditors in certain circumstances. Finally, rules of ‘shareholder liability’, the fourth category, permit claims to be brought directly against shareholders personally, or otherwise impose liability on them in disregard of the concepts of limited liability and separate personality. This section compares the Thai approach in relation to each concept with English and German law evaluates each against the ESV model of corporate governance.

2.1 Legal capital rules

In relation to protection of non-adjusting creditors, the primary function of legal capital rules is to ensure that capital initially contributed by shareholders to a company cannot be returned to the shareholders without safeguards to protect the interests of creditors.¹⁶ This may be referred to as the concept of ‘capital maintenance’. Actions which potentially violate this concept, resulting in asset dilution, may be categorised, for convenience in analysis, as either ‘direct’ or ‘indirect’ reductions of capital. The former are overt distributions of assets to a shareholder, for example dividend payments, while the latter are more concealed transfers of value, such as the purchase by a shareholder of company assets at less than their true value.

There are two primary sources of relevant provisions in Thai law, the CCC and the Offences Act.¹⁷ In relation to direct reductions of capital, the relevant provisions relate to paying dividends to shareholders,¹⁸ the company repurchasing or redeeming shares from

¹⁵ This article does not include criminal laws relating to deliberate deception, such as fraud, in its analysis.

¹⁶ Eilis Ferran and Look Chan Ho, *Principles of Corporate Finance Law* (2nd edn, Oxford University Press 2014) 242

¹⁷ Act Prescribing Offences Related to Registered Partnerships, Limited Partnerships, Limited Companies, Associations and Foundations BE 2499 (1956) (‘Offences Act’).

¹⁸ Primarily Sections 1201-2 of the CCC and Section 19 of the Offences Act.

shareholders,¹⁹ and the statutory reduction of capital procedure.²⁰ In relation to indirect reductions of capital, the relevant provisions relate to requirements to pay up calls on shares,²¹ the prohibition on cancelling share subscriptions²² and the prohibition on setting off calls on shares against debt owed by the company.²³

In comparison to England and Germany, there are several points of difference in these rules. In relation to direct distributions, for both English law and German law, even properly prepared accounts do not have the final word on whether dividends are payable, unlike Thai law. Rather, in both of these systems, the directors must have regard to the future solvency of the company in the period following the distribution of the dividends.²⁴ This forward-looking solvency-based requirement is not present in Thai law. However, Thai law, unlike the other systems, has a 10% legal capital reserve which reduces profits available for distribution. This may perform a similar function – attempting to prevent asset dilution where a company suffers loss after accounts are prepared. However, it is a one-size-fits-all approach that does not reflect the context or financial prospects of the business in question at the time the payment is made.

In relation to indirect distributions, there is a divergence among the three jurisdictions as to when a transaction will be considered a ‘distribution’ and thus subject to legal capital rules. At one end of the spectrum, German law broadly defines a ‘disguised distribution’ as any transaction or series of transactions that results in a net transfer of assets away from the company.²⁵ At the other end of the spectrum, Thai law takes a narrow approach to disguised distributions. Only direct cash payments to shareholders are typically considered dividends under Thai law: other transactions that indirectly pass value from the company to shareholders are generally not reclassified as disguised distributions, except in cases of criminal offenses pursuant to Section 19 of the Offences Act. English law falls somewhere in the middle, requiring an intention to distribute a company's assets to shareholders before a transaction can be considered a distribution.²⁶

Regarding the ESV evaluation, there are a number of features that do not fit well with the normative model. These include the complete prohibition on share repurchases and the requirement to contribute 25% of share capital and all share premium on subscription.

¹⁹ Primarily Section 1143 of the CCC and Section 12 of the Offences Act.

²⁰ Primarily Section 1224 of the CCC and Section 22 of the Offences Act.

²¹ Primarily Sections 1105, 1106, 1120 and 1123-6 of the CCC.

²² Section 1114 of the CCC.

²³ Section 1119 paragraph 2 of the CCC.

²⁴ For English law, see Sections 851 and 852 of the Companies Act 2006; for German law, see Sections 30 paragraph 1 and 64 paragraph 3 of the GmbH Act.

²⁵ OLG Köln AG 2009, 584, 587; OLG Koblenz AG 2007, 408, 409.

²⁶ *Progress Property Co Ltd v Moorgarth Group Ltd* [2010] UKSC 55.

However, the most significant deficiency, from the perspective of non-adjusting creditors, is the reliance on the legal capital reserve for creditor protection in a situation where a company has suffered losses after the preparation of accounts, described above. This could result in asset dilution – shareholders recovering funds from a company in priority to creditors – if a company suffers significant losses after the preparation of accounts for a period that shows a profit. Such asset dilution would therefore inappropriately reduce the potential recoveries of non-adjusting creditors.

2.2 Challenging transactions²⁷

This category of rules allows creditors, or an insolvency office holder acting on their behalf where the debtor is in bankruptcy, to challenge transactions entered into between the debtor and third parties prior to formal bankruptcy proceedings. Such transactions include both ‘transactions at an undervalue,’ or so-called ‘fraudulent transactions,’ which result in a net movement of assets away from the debtor company, and ‘preferential transactions’ where payments are made to some creditors in preference to others.

The ability to challenge fraudulent transactions addresses asset dilution by unwinding or reversing the effect of transactions which reduce the value in the debtor company. This reinforces bankruptcy law’s ‘anti-dilution’ principle.²⁸ By contrast, preferential transactions do not reduce the net asset value of the debtor company, since they constitute repayments of debts. However, preferential transactions violate the concept that creditors must share rateably in the assets of the debtor, sometimes known as the ‘*pari passu*’ principle.²⁹ The challenge to fraudulent transactions is compatible with the ESV model of corporate governance in a similar manner to capital maintenance rules discussed above. The challenge to preferential transactions has particular relevance for non-adjusting creditors, where their potential recoveries would otherwise be reduced by payments made to more powerful creditors.

In Thai law, creditors may challenge so-called fraudulent transactions by way of Section 237 of the CCC. The insolvency office holder has two routes of challenge, via the BA: fraudulent transactions³⁰ and preferential transactions occurring during the three months prior to formal insolvency proceedings.³¹ However, where the fraudulent transaction either arose

²⁷ For more detail on the concepts discussed in this section, see Adam Reekie, ‘Challenging “Fraudulent” Transactions and Protecting Company Creditors in Thailand: A Comparison with English and German Law’ (2019) 37(2) Chulalongkorn Law Journal 135–168.

²⁸ Royston Miles Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 219.

²⁹ Michael G Bridge, ‘Collectivity, Management of Estates and the *Pari Passu* Rule in Winding Up’ in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Oxford University Press 2003) 1–4.

³⁰ Section 113 of the BA, which links to Section 237 of the CCC.

³¹ Section 115 of the BA.

within the one-year period prior to the bankruptcy petition, constitutes a gratuitous act or an act under which the debtor received unreasonably small remuneration, the insolvency office holder benefits from a presumption regarding proof of the required mental element.³² In relation to preferential transactions, where the advantaged creditor is the debtor's insider, the three-month period is extended to one year prior the bankruptcy petition.³³

From a comparative perspective, the rules for challenging transactions differ significantly across the three jurisdictions. English law has traditionally focused on preventing fraud and primarily considers the debtor's mental state, tracing the origins of the legal rules back to the 16th-century Statute of Elizabeth.³⁴ In contrast, German law, tracing its origin back to the differently conceived *actio pauliana* in Roman law, balances interests between creditor-debtor and debtor-counterparty relationships and focuses on preventing collusion between them.³⁵ Thai law, having initially adopted the English bankruptcy law model, replaced this with the *actio pauliana* model through its adoption of Section 237 of the CCC and the link with bankruptcy law in Section 113 of the BA.³⁶

However, while Thai law and German law have retained the requirement to find a mental element on the part of the debtor and counterparty to challenge transactions, be they fraudulent or preferential (albeit with presumptions in a relatively short period prior to insolvency), English law has developed a purely objective test: where an undervalue transaction occurs during the two-year period prior to formal insolvency proceedings, the insolvency office holder may bring a successful challenge without the requirement to prove any mental state of the debtor or the counterparty.³⁷

Furthermore, it should be noted that although Germany does not have a similar objective test in this area, due to its development of the concept of 'disguised distributions' referred to above, transactions that, in English law, would be treated with rules relating to challenging transactions will be addressed through objective legal capital rules. This reveals that Thailand, alone of the three jurisdictions, does not use an objective test to address such situations of asset dilution: instead, its legal framework requires mental elements, addressing only unethical conduct of the debtor and counterparties, and prioritising the protection of innocent counterparties in the business environment.

The conclusion of this evaluation, that Thai law lacks an objective means of addressing transactions resulting in asset dilution, might lead to a proposal to revise the law to include such objective means. However, the comparative analysis reveals that Thai law has not

³² Section 114 of the BA.

³³ Section 115 paragraph 2 of the BA.

³⁴ Statute of 13 Elizabeth 1 of 1571.

³⁵ Reekie (n 27).

³⁶ Ibid.

³⁷ Section 238 of the Insolvency Act 1986.

developed such an objective test, either through evolving its challenging transactions rules or by adapting its legal capital rules. Therefore, it might be argued that, since this is not an area of law on which Thailand has focused for its protection of non-adjusting creditors, recommendations for improvement should focus on areas which have received more emphasis in terms of the adoption of relevant legal rules.

2.3 Directors' duties and obligations to preserve creditors' interests

This category of rules concerns the duties which the law confers on those making business and policy decisions concerning the company, and the sanctions for breach of those duties. Such duties can be split into two subcategories. First, the duties that directors owe at all times, or 'general duties', and second those that apply when a company encounters financial difficulties, or 'duties to preserve creditors' interests in financial difficulties.' From an ESV perspective, non-adjusting creditors are among the different constituencies to which directors should have regard in making decisions. However, while the company is fully solvent and able to pay its debts, non-adjusting creditors' interests presumably do not need to be taken into account other than in decisions that threaten its ability to pay.³⁸ However, this changes where the company encounters financial difficulties and faces insolvency: at this point, non-adjusting creditors replace shareholders as the residual claimants.³⁹ At this point, under the ESV model, the company should be run in their interests.⁴⁰

In Thai law, the core provisions on directors' general duties are Sections 1167–1169 of the CCC, from which doctrine has developed two general duties: the duty of loyalty and the duty of care. In addition, Thai law provides a number of relevant specific criminal offences in relation to directors' conduct, generally and in the period prior to insolvency.⁴¹ Indeed, the inclusion of these criminal offences is noteworthy: although influenced by foreign sources, including contemporary English and German law, the framework of Thai law differs in its emphasis, even at the time of its adoption, on public enforcement of standards of directors' conduct via the criminal law.

Both English law and German law in this area have been revised throughout the 20th century, generally in the direction of increasing the protection of creditors. Various mechanisms have been incorporated, including requirements for directors to file for formal

³⁸ Paul Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7 *European Business Organization Law Review* 301, 303–5.

³⁹ Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 *The Modern Law Review* 665, 668. Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 69; Douglas G Baird and Thomas H Jackson, 'Bargaining after the Fall and the Contours of the Absolute Priority Rule' (1988) 55 *University of Chicago Law Review* 738, 774–5.

⁴⁰ Andrew Keay, 'Directors' Duties and Creditors' Interests' (2014) 130 *Law Quarterly Review* 443, 459–62.

⁴¹ Sections 40-1 of the Offences Act, which apply generally, and Sections 164, 166 and 173 of the BA.

insolvency processes, legislative changes to directors' duties, judicially developed shifts in directors' duties when a company encounters financial difficulties, and a direct tortious relationship between directors and creditors.⁴² In addition, both English and German law have developed a legal framework to disqualify misbehaving directors.⁴³ Thai law has not developed any of these creditor-protective mechanisms in respect of directors' duties, but instead relies on provisions of criminal law. The Offences Act contains general prohibitions on transferring assets away from the company to avoid creditors' claims and on obtaining benefits by causing loss to the company.⁴⁴ The BA also confers a range of criminal offences for misbehaviour in the one-year period prior to bankruptcy, including dishonestly dissipating the company's assets, failing to give reasons for large losses, and creating debts without any cause to believe that they will be paid.⁴⁵

This analysis exposes significant weaknesses in Thai law, when evaluated from an ESV perspective. Specifically, it lacks an effective means of ensuring that directors make decisions in the interests of the company's creditors when a company is in financial difficulties, as required by the ESV model of corporate governance. Thai law has neither developed a shift in directors' duties nor a direct tortious relationship between directors and creditors, as in English law and German law respectively. In addition, Thai bankruptcy law has not incorporated a requirement on company directors to petition quickly, or at all, for a formal insolvency process designed to protect creditors' interests. Furthermore, Thai law has not developed a mechanism for director disqualification, either through interpretation of professional prohibitions in criminal law, as in German law, or through specific legislation as in English law.⁴⁶ However, Thai law evidently relies, for creditor protection in this area, on *public enforcement*, via the criminal provisions under the Offences Act and the BA, under which the insolvency office holder may take action.

Therefore, since, as revealed by the comparative analysis, Thai law has emphasised public enforcement in its creditor protection framework, it is on this area that recommendations will focus, to reform Thai law to bring it into closer alignment with ESV normative principles. These are outlined in Section 3 below.

⁴² For English law, see Section 172(3) of the Companies Act 2006 and the concepts of fraudulent and wrongful trading through Sections 213-4 of the Insolvency Act 1986. For German law, see Section 15a of the InsO, Section 64 of the GmbH Act and Section 823(2) of the BGB.

⁴³ For England, see the Company Directors Disqualification Act 1986. For Germany, see Section 70(1) Criminal Code, Section 35 GewO (Trade Regulations), and Section 6(3) GmbH Act.

⁴⁴ Sections 40-1 of the Offences Act.

⁴⁵ Sections 164, 166 and 173 of the BA.

⁴⁶ See n 43.

2.4 Shareholder liability

The final category of rules imposes liability directly on shareholders for debts owed by the company. Mechanisms which impose such liability essentially disregard one or both of two fundamental concepts of company law mentioned at the start of this article: limited liability of shareholders and the separate personality of the limited company. This article separates these mechanisms into two categories. The first is ‘piercing the corporate veil’: mechanisms permitting courts to disregard the separate personality of the company, resulting in direct liability of shareholders for the debts of the company.⁴⁷ The second category covers legal mechanisms which confer liability on shareholders due to the level of control that they exercise over the company’s business: this may result in liability between shareholders and creditors, where the law considers that controlling shareholders owe them duties, for example, or in liability between the shareholders and the company itself if, for example, interference of shareholders in the business resulted in its failure.

Although, as referred to above, Thai law generally recognises the separate legal personality of the company and the limited liability of its shareholders,⁴⁸ there are two relevant⁴⁹ mechanisms under which these may be disregarded. The first is the judicially developed concept of piercing the corporate veil. Some academics have suggested that this is possible through an application of Section 5 of the CCC, the general requirement to act in good faith,⁵⁰ in situations including ‘*alter ego*’, when the company is acting only as a puppet of the shareholders through complete domination, and in situations of dishonesty or impropriety, such as using the company improperly to avoid provisions of law or contractual obligations.⁵¹ However, the absence of Supreme Court cases clearly evidencing this mechanism and its absence or only passing mention in many textbooks implies, at the very least, that this is a highly exceptional process.⁵²

⁴⁷ Easterbrook and Fischel (n 3) 109.

⁴⁸ Sections 1015 and 1096 CCC.

⁴⁹ There are additional statutory exceptions, such as in relation to war or taxation, but none are relevant to the protection of non-adjusting creditors.

⁵⁰ Sophon Ratanakorn, *Explanation of the Provisions of the Civil and Commercial Code relating to Partnerships and Companies* (12th edn, Nitibannagarn 2010) 267 (Thai language).

⁵¹ Pithitul Jiramongkonpanich, *Disregarding Separate Corporate Personality* (Thammasat University 2013) 56 (Thai language).

⁵² These include Sahaton Rathanapaichitr, *Explanation of the Principles of Partnership and Company Law* (6th edn, Winyuchon Publication House 2020) (Thai language); Nontawach Nawathragulwisuth, *Legal Principles of Partnerships, Limited Companies and Public Limited Companies* (4th edn, Winyuchon Publication House 2019) (Thai language). Many Supreme Court decisions cited in support of this concept can be explained by the application of other legal rules, such as capital maintenance rules or vicarious liability, including 3119/2526, 1560/2527, 174/2528, and 2466/2542.

The second mechanism is Section 44 of the CCPA.⁵³ Under this provision, in a consumer case, if it appears that the company (i) was incorporated or has acted in bad faith, has behaved deceitfully towards consumers, or has embezzled property for someone's benefit, and (ii) has insufficient funds to satisfy the obligation to pay compensation, the court may summon the shareholders, persons who are able to control the operation of the company, or persons who received property from the company, and hold them jointly liable for the company's obligation. The relevant person may be relieved from liability if she can prove her innocence. However, aside from this potentially important mechanism for protecting consumers – one group of non-adjusting creditors – in cases involving bad faith, Thai law has not developed shareholder liability concepts based on control of the company.

Similarly, to Thai law, both English and German law take a restrictive view of piercing the corporate veil, which may now be considered an approach of last resort.⁵⁴ However, both English and German law have developed expansive approaches to shareholder liability based on control of the company. Regarding English law, the concept of 'shadow directors' imposes the same legal regime relating to directors' duties on shareholders who exercise control over directors, including general directors' duties and liability for wrongful and fraudulent trading.⁵⁵ Thus, the English law approach is to tie the shareholder liability regime to its directors' duties regime. German law also extends its regime of director liability to controlling shareholders, but uses tort law principles to do so. In the *Trihotel* decision,⁵⁶ the German courts confirmed that shareholders may be liable for the tort of destroying the company's existence – intentionally or recklessly causing damage to the company through conduct which is contrary to good morals. The proper claimant is the company itself, although it seems that in practice the insolvency office holder will be the one to claim on behalf of the creditors.

The comparative analysis thus reveals that Thailand has taken a markedly different approach to the other jurisdictions to this concept: rather than expanding the regime relating to directors, Thai law has adopted a separate approach, restricted to consumer cases and to situations involving bad faith. It is considered that this is a potentially important mechanisms for protecting consumers – one type of non-adjusting creditor – where they have become the company's residual claimants, providing incentives for shareholders to use their influence to ensure that the company does not engage in bad faith or deceitful activities. For these reasons,

⁵³ Consumer Cases Procedure Act BE 2551 (2008) ('CCPA').

⁵⁴ The approach of each jurisdiction has been clarified through the cases of *Prest v Petrodel Resources* (2013) UKSC 34 (England) and *Trihotel*, BGH, Judgment of 16 July 2007 (II ZR 3/04) (Germany).

⁵⁵ Section 251 of the Companies Act 2006 defines a shadow director as "a person in accordance with whose directions or instructions the directors of a company are accustomed to act". Many statutory duties relating to directors in the Companies Act 2006 also apply to shadow directors.

⁵⁶ *Trihotel*, BGH, Judgment of 16 July 2007 (II ZR 3/04)

it is considered that Section 44 of the CCPA is consistent with the ESV approach, albeit only in relation to consumers.

3. Recommendations

The evaluation of Thai law regarding the protection of non-adjusting creditors in Section 2 has revealed several areas where Thai law is not aligned with the ESV normative model. Based on the comparative analysis, which has highlighted areas of emphasis and development within the legal framework, this article makes the following recommendations.

1. Public enforcement of directors' duties via administrative sanctions and director disqualification regime. As discussed above, Thai law emphasises protection of non-adjusting creditors via public enforcement by way of criminal law. However, it has not, unlike the comparator jurisdictions, adopted a regime for disqualifying misbehaving individuals from acting as directors in the future. Therefore, this article recommends adopting such a regime, which would act *ex ante* by discouraging this harmful conduct.

The suggested regime, which would likely require an Act of Parliament and associated Ministerial Regulations for implementation, would prescribe automatic disqualification of directors on the commission of certain criminal offences,⁵⁷ disqualification by the court for repeated abusive behaviour, and administrative sanctions, generally modelled on the Trusts for Transactions in Capital Markets Act,⁵⁸ to be imposed by a government department, for example the Department of Business Development, for abusive behaviour prior to insolvency. This recommendation addresses weaknesses in the challenging transactions and directors' duties regimes.

2. Recognition of directors' duties to act in the interests of creditors. Such duties would be taken into account in the public enforcement regime in Recommendation 1. This recommendation also addresses weaknesses against the ESV model identified in the challenging transactions and director's duties regimes.

3. Empowering and requiring company directors to initiate formal insolvency proceedings when appropriate, including consideration of non-adjusting creditors. At present, company directors cannot themselves file a petition for bankruptcy or, in some cases, for business rehabilitation. The third recommendation would be to remedy this by amendments to the BA. A failure to consider filing for protection of a formal insolvency regime would link with the public enforcement regime in Recommendation 1. This addresses the

⁵⁷ E.g. Conviction for offence under Sections 40 and 41 of the Offences Act, Section 350 of the Penal Code and Sections 164, 166 and 173 of the BA.

⁵⁸ Trusts for Transactions in Capital Markets Act B.E. 2550 (2007). For detail, see Adam Reekie, Surutchada Reekie and Kaipichit Ruengsrichaiya, 'Legal Landscape of Trust Law in Thailand: The Fading Twilight of Common Law Trusts and the Sunrise of Statutory Trusts' (2021) 27 *Trusts & Trustees* 830.

weakness against the ESV model identified in the directors' duties regime of a lack of a shift to contemplate an insolvency procedure to protect creditors' interests.

4. Expanding CCPA approach beyond consumers. This article recommends expanding the approach in the CCPA to include all wrongful acts, addresses weaknesses in the shareholders' liability regime which result in incentives that run contrary to the ESV model.

5. Revising the interpretation of the law relating to dividend distributions. This article would recommend including a requirement for directors to ensure that the company has sufficient funds to maintain insolvency on the payment of dividends, rather than relying on the position revealed by audited accounts. This addresses weaknesses in the current regime relating to the legal capital reserve which, as argued, is ineffective, inefficient and lacks normative justification.

4. Conclusion

This article has analysed the Thai legal framework relating to the protection of non-adjusting creditors of private limited companies in Thailand. Non-adjusting creditors, not recognised as a separate category of creditors in law or legal doctrine, are identified by economics literature as those who are unable to negotiate the terms on which they extend credit to a company. They may be voluntary, making the decision to extend credit, or they may be involuntary, such as in the case of tort victims. Their inability to negotiate contractual or proprietary protections leaves them exposed to potentially abusive actions of the debtor company, including asset dilution, asset substitution and debt dilution.

This article has used the ESV model of corporate governance, adopted in the Thai business landscape via the CG2017, as an evaluative tool to analyse the legal regime. This regime has been divided, for convenience in analysis, into four concepts along the lines of the relevant group targeted: legal capital rules, challenging transactions, directors' duties and obligations to preserve creditors' interests, and shareholder liability. In addition to the ESV normative evaluation, this article has performed a comparative analysis with English and German law, regimes which influenced Thai law at the time of its adoption, to highlight the path of development of, and areas of emphasis in, Thai law.

Based on the ESV evaluation and the comparative exercise, this article makes six recommendations to bring Thai law on the protection of non-adjusting creditors into closer alignment with the ESV normative model, foremost among which is to create a regime of public enforcement by way of administrative sanctions including a director disqualification regime.