

ALLEN & OVERY

Directors' duties and liabilities in financial distress during Covid-19

July 2020

Directors' duties and liabilities in financial distress during Covid-19

A global perspective

Uncertain times give rise to many questions

The Covid-19 pandemic and the ensuing economic crisis has a significant impact, both financial and otherwise, on companies around the world. Boards are struggling to ensure survival in the short term and preserve cash, whilst planning for the future, in a world full of uncertainties.

Many directors are uncertain about their responsibilities and the liability risks in these circumstances. They are facing questions such as:

- If the company has limited financial means, is it allowed to pay critical suppliers and leave other creditors as yet unpaid? Are there personal liability risks for 'creditor stretching'?
- Can you enter into new contracts if it is increasingly uncertain that the company will be able to meet its obligations?
- Can directors be held liable as 'shadow directors' by influencing the policy of subsidiaries in other jurisdictions?
- What is the 'tipping point' where the board must let creditor interest take precedence over creating and preserving shareholder value?
- What happens to intragroup receivables subordinated in the face of financial difficulties?
- At what stage must the board consult its shareholders in case of financial distress and does it have a duty to file for insolvency protection?
- Do special laws apply in the face of Covid-19 that suspend, mitigate or, to the contrary, aggravate directors' duties and liability risks?



There are more jurisdictions involved than you think

Most directors are generally aware of their duties under the governing laws of the country from which the company is run. However, individuals may also be directors of subsidiaries in other jurisdictions, either personally or indirectly through holding or management entities of which they are directors. And even if they are not, the laws that govern the subsidiaries may classify them as shadow directors of the subsidiary. All this may expose directors to duties and liability risks at local levels.

To complicate matters, liability may not only arise under local company law, but also under tort laws of countries where contracts are entered into that later cannot be performed, causing damages to the company's counterparties. Insolvency proceedings may be opened in yet more jurisdictions where the company or its subsidiaries do business and local insolvency laws may contain specific directors' duties and liability regimes.

Guidance to navigating these risks

We have put together an overview of the main issues facing directors in financially uncertain times in a number of key jurisdictions across the globe. This includes a brief general description of directors' duties and key areas of potential directors' liability in each country, as well as some answers to the questions listed above.

Obviously, the duties and liabilities that may arise will always be dependent on the circumstances. Therefore, this publication should not be used as legal advice when faced with a specific dilemma. However, we hope it may help to alert directors and their in-house advisors to the duties, pitfalls and liability risks that exist in major jurisdictions across the globe.



Thailand

No.	Question	Answer
Directors' Duties		
1.	Do directors have to act primarily in the interest of their shareholders or do they have to take in account other stakeholders' interests as well? Does that regime change in case of financial distress?	<p>The duties and liabilities of directors are set out under the Civil and Commercial Code, as amended (the Code), for directors of a private company and the Public Limited Companies Act B.E. 2535, as amended (the PLCA), for directors of a public company. The Securities and Exchange Commission Act B.E. 2535, as amended (the SEC Act), also applies to directors of a public company whose shares have been offered to the public and/or listed in the Stock Exchange of Thailand.</p> <p>Under the CCC, the PLCA and the SEC Act, in managing the company's business operations, directors must manage the company within the scope of powers given to them under the company's objectives, articles of association and resolutions of meetings of shareholders. Directors must apply the same degree of diligence and care as may be reasonably expected of a careful businessperson. As a fiduciary, a director must act in good faith and with care to preserve the interests of the company. Accordingly, in normal circumstances, directors are required to act primarily in the interest of the company and its shareholders as a whole.</p> <p>Under Thai law, even when a company is in financial distress or insolvent, there is no provision which clearly provides that the interest of creditors outweigh those of shareholders or the directors shall act in the interest of the creditors instead of the shareholders. However, there are a number of provisions in the Bankruptcy Act, B.E. 2483, as amended (the Bankruptcy Act) which gives priority to creditors rights. For example:</p> <ul style="list-style-type: none">– under bankruptcy proceedings, creditors' rights to receive payment take priority over the rights of shareholders¹;– once the company is placed under the receivership order, the company (including its shareholders) is prohibited from dealing with its assets or business; these rights are transferred to the court, official receiver or creditors' meeting²;– under rehabilitation proceedings, the rights of shareholders (except the right to dividends) are suspended and transferred to the interim manager, the official receiver or the plan preparer³; and– under rehabilitation proceedings, creditors have the right to vote on the business rehabilitation plan whereas shareholders do not⁴.

1_Shareholders get paid out after all types of creditors are paid out (Section 130 (7) of the Bankruptcy Act).

2_Section 24 of the Bankruptcy Act

3_Section 90/21 of the Bankruptcy Act

4_Section 90/44 of the Bankruptcy Act



No.	Question	Answer
2.	What are the key areas of potential liability for directors when a company is in financial difficulties?	<p>General Director's Liabilities</p> <p>Under Thai law, generally, a director is not liable for damage to the company and its shareholders for acts which accord with the articles of association of the company or shareholders' resolution, or acts done in good faith which are within the scope of their duties. In particular:</p> <ul style="list-style-type: none"> – the Code provides that directors are not liable to the shareholders or the company for acts which have been approved by the shareholder's meeting⁵ and a company must compensate third parties for damage caused by its directors in the course of performing their duty. However, if the act is not within the scope of powers of the company (i.e. ultra vires the company), the company's directors involved in carrying out the act must compensate third parties and/or the Company for the damage caused by that act⁶; – the PLCA provides that directors are jointly liable for a breach of their fiduciary duties but a director may be released from liability if (i) that director can prove that they did not participate in the act or the act was done without a board resolution⁷ or (ii) that director objected at the board meeting and either the objection was noted in the minutes or made in writing and submitted to the chairman within three days after the meeting⁸; – the SEC Act provides that if the director or executive can prove that, at the time of considering a particular matter, their decision has met the following requirements, it shall be deemed that the said director or executive has performed their duty with responsibility and due care and the director shall not be liable for damages following an accusation of violation of the director's responsibility and duty of care: <ul style="list-style-type: none"> (i) the decision has been made with honest belief and reasonable ground that it is for the best interest of the company; (ii) the decision has been made in reliance of information honestly believed to be sufficient; and (iii) the decision has been made without the director having an interest, whether directly or indirectly, in such matter⁹. <p>However, in the event that the director acted dishonestly, fraudulently or in bad faith, that director will not be discharged from such liability.</p>

⁵Section 1170 of the Code

⁶Section 76 of the Code

⁷Section 92(1) of the PLCA

⁸Section 92(2) of the PLCA

⁹Section 89/8 of the SEC Act



No.	Question	Answer
		<p>Key Director's Liabilities in time of Financial Difficulties</p> <p>Below are key areas of potential liabilities of the directors in the event that the company is in financial difficulties or insolvent.</p> <p><i>The Bankruptcy Act</i></p> <p>The director may be subject to criminal liabilities if:</p> <ul style="list-style-type: none"> – during a one-year period prior to the filing of bankruptcy petition and thereafter, but before the issuance of a receivership order, they undertake any of the following actions: <ul style="list-style-type: none"> (i) removing, concealing, destroying, causing damage to or altering the seal, accounting ledgers, or documents relating to the company's business or assets, or conniving in such action, unless it can be proven that there is no intention to conceal the actual status of the business; (ii) omitting to record material matters, or making false entries in the accounts or documents relating to the company's business or assets, or conniving in such action; (iii) pledging, mortgaging, or disposing of assets obtained by purchasing on credit for which the full price has not been made, unless it can be proven that it is in the normal course of business and there is no intention of fraud; or (iv) receiving goods on credit from third parties on false pretenses, or concealing, transferring, or delivering the company's assets dishonestly, or taking actions or permitting others to take actions to create encumbrance over the company's assets by dishonest means, or allowing or conspiring with others so that the court may issue a judgment against the company to pay a debt which the company should not have to pay¹⁰; – they remove, conceal, accept, dispose of or manage the company's assets with dishonest intent, while knowing that a receivership order has been or will be made¹¹; – they cause the company to incur debts at the time when the company's assets are placed under receivership without reasonable grounds for believing that the company will be able to repay such debts¹²; – the company failed to keep proper books of account in the three-year period prior to the making of a receivership order¹³.

10_Section 164 of the Bankruptcy Act

11_Section 173 of the Bankruptcy Act

12_Section 166(2) of the Bankruptcy Act

13_Section 167 of the Bankruptcy Act



No.	Question	Answer
		<p><i>The Criminal Code</i></p> <ul style="list-style-type: none"> – Any director who removes, conceals or transfers assets of the company to another person so that a creditor or the company's creditor, who has commenced or is about to commence legal action to enforce payment, is deprived of payment, could be liable to a fine of up to THB 40,000, imprisonment for a term of up to two years, or both¹⁴. – Any director who deceives another person by disclosing false information or omitting to disclose information which should have been disclosed and as a result of such deception (i) acquires assets from the deceived or a third person, or (ii) causes the deceived or third person to produce, waive or destroy documentary evidence of certain rights, may be liable for a fine of up to THB 60,000, imprisonment for a term of up to three years, or both¹⁵. – Any director who takes away, destroys or devalues a pledged asset in order to cause damage to the pledge may be liable for a fine of up to THB 40,000, imprisonment for a term of up to two years, or both¹⁶.
3.	Does liability rest only with formally appointed directors, or also with (other) officers or de facto directors? If so, what are the standards to qualify as such?	The liabilities of directors are imposed on every director of the company. In addition, the liabilities under SEC Act also extend to executives ¹⁷ of the company.

14_Section 350 of the Criminal code

15_Section 341 of the Criminal code

16 Section 349 of the Criminal Code

17_ Executive refers to a manager or person responsible for the management of the company whether de facto or as authorized by the board of directors as prescribed in relation to the notification of the Capital Market Supervisory Board.



No.	Question	Answer
4.	What are the standards for directors' liability for the company having entered into contracts that the company can later not perform ('wrongful trading')?	<p>The director could be held liable to the creditors for a fraudulent transaction where they approve, with the intention of defrauding the creditor, that the company enters into new obligations when, at that time, they know or should have known that the company will not be able to fulfil such obligations. In addition, the directors could also be held liable to the company and/or the shareholders if the directors act with the knowledge that such transaction approved by them would cause damages to the company. The analysis in this regard is much dependent on the circumstances.</p> <p>Under the PLCA, the shareholders may request the Department of Business Development to appoint an inspector to investigate the company if there is any reason to believe that the company is trying to defraud its creditor or incurring debt whilst knowing that the company cannot repay those debts¹⁸. If the directors are found guilty, the inspector must report such findings to the relevant government official so that the official may bring a direct claim against those directors.</p> <p>In addition, under the Bankruptcy Act, any director who causes the company to incur debts at the time that the company's assets are placed under receivership without reasonable grounds to believe that the company will be able to repay such debts, is liable for a fine up to THB 100,000 or imprisonment for a term of not more than one year¹⁹.</p>
5.	What are the liability risks in the case of 'creditor stretching'?	<p>Absent particular facts (for example, where a director fraudulently or negligently misstates the company's financial position), managing a company's cashflow ('creditor stretching') in times of financial distress is a relatively normal way for a company to seek to find the time to restructure. If the director has a reasonable ground for believing that 'creditor stretching' has been done in good faith and for the best interest of the company, and they applied the same degree of diligence and care as may be reasonably expected of a careful businessperson, it would not typically lead to personal liability of directors.</p>
6.	What are the liability risks in case of selective payments to some but not all creditors in case of liquidity issues? Is there a stage at which directors must treat all creditors equally?	<p>If a director applies the same degree of diligence and care and has a reasonable ground to believe that the selective payments are for the best benefit of the company, it would not typically lead to personal liability of directors. However, the analysis is much dependent on circumstances.</p> <p>It is worth noting that if a company enters into bankruptcy proceedings under the Bankruptcy Act, the court may, on the application of the official receiver under Section 115 of the Bankruptcy Act, set aside a transfer of an asset or any act done or permitted to be done by the company with the intention of giving undue preference to any creditor over the others within three months before the bankruptcy petition is filed (or where the preferred creditor is an "insider"²⁰ of the company, one year before the filing of the bankruptcy petition or at any time after the filing of that petition).</p>

18_Section 129 of the PLCA

19_Section 166(2) of the Bankruptcy Act

20_An insider means:

(1) a director, manager, managing partner, partner with unlimited liability, or person responsible for the operation of business or auditor of the debtor;
 (2) a shareholder holding shares in excess of five percent of the total number of shares already sold of the debtor's undertaking;
 (3) a spouse or a non sui juris child of the debtor or of the person under (1) or (2);
 (4) an ordinary partnership of which the debtor or the person under (1) or (2) or (3) is a partner;
 (5) a limited partnership of which the debtor or the person under (1) or (2) or (3) is a partner with unlimited liability or is a partner with limited liability and with the aggregate shares held in excess of 30 percent of the total number of shares of the limited partnership;

(6) a limited company or a public limited company with the debtor or the person under (1) or (2) or (3) or the partnership under (4) or (5) holding shares in the aggregate number in excess of 30 percent of the total number of shares already sold of such company;
 (7) a limited company or a public limited company with the debtor or the person under (1) to (6) holding shares in the aggregate number in excess of 30 percent of the total number of shares already sold of such company;
 (8) a director, manager, managing partner, partner with unlimited liability, person responsible for the operation of business or auditor of an ordinary partnership, a limited partnership, a limited company or a public limited company under (4) or (5) or (6) or (7), as the case may be, or the spouse and a non sui juris child of such person.



No.	Question	Answer
7.	Is there a distinction in this regard between preferential treatment of related entities and the treatment of other creditors?	The same rule as prescribed in 6 above will apply.
8.	Is there an obligation in case of financial difficulties to convene a shareholders' meeting and, if so, at what stage of financial difficulties?	<p>The board of directors of a private limited company has a duty to call for an extraordinary general meeting of shareholders when the company is significantly at loss (i.e. loss equals to or more than a half of the company's capital)²¹. If they fail to do so, each director is criminally liable with a penalty not exceeding THB 20,000 under the Act on Offences Concerning Registered Partnerships, Limited Partnerships, Limited Companies, Associations and Foundations B.E. 2499, as amended.</p> <p>For a public limited company, there is no requirement that the board of directors must convene a shareholders' meeting in the event of financial difficulties, unless there are specific provision in the articles of association to that effect.</p>
9.	Is there an obligation at some stage to file for bankruptcy or other statutory insolvency protection regimes?	<p>Under Thai law, there is no requirement for directors to commence bankruptcy and rehabilitation proceedings.</p> <p>Under Section 9 of the Bankruptcy Act, the creditor, only can file for bankruptcy against the debtor when certain conditions are met. Thai law does not allow voluntary bankruptcy to be initiated by the debtor. However, in rehabilitation proceedings, a company, as a debtor, can file for voluntary rehabilitation under the Bankruptcy Act if the following conditions are met:</p> <ul style="list-style-type: none"> (i) it becomes insolvent or unable to pay its debt when due; (ii) it is indebted to one creditor or several creditors altogether in a definite amount of not less than THB 10 million, whether such debt is due immediately or at a future time; and (iii) there is a reasonable cause and prospect for the rehabilitation of the debtor's business.

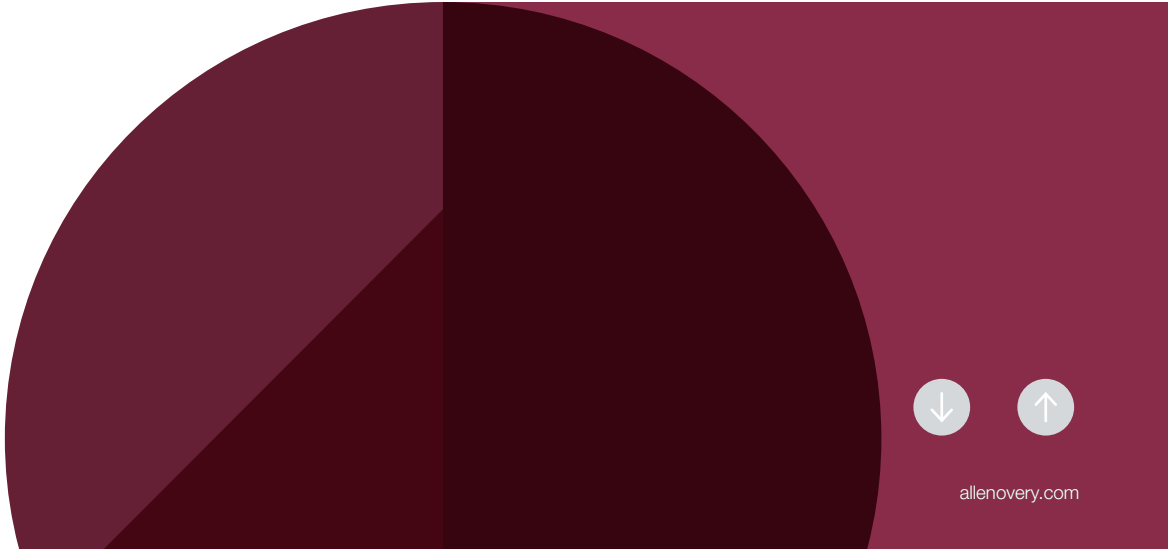
21_ Section 1172 of the CCC



No.	Question	Answer
10.	Are there special liability risks in respect of certain debts, such as tax debts, social security payments, and pension contributions?	<p>In addition to the general liabilities of directors under company laws of Thailand, directors also have liabilities under other specific laws which could result in administrative and/or criminal penalties, including:</p> <p>(i) Liability under the Revenue Code</p> <p>Generally, by virtue of Section 90/5 of the Revenue Code, the managing director, directors or any persons acting in a representative capacity for a company shall be personally liable to the same penalty imposed on the company for any violation by the company of the Revenue Code (including failure to pay tax), except where such person can prove that they did not consent or had no part in such wrongdoing of the company.</p> <p>(ii) Liability under the Social Security Act B.E. 2533 (1990) (SSA)</p> <p>By virtue of Section 110 of the SSA, where an offence is committed by a company and is penalised in accordance with the SSA, it shall be deemed that the representative(s), every director, and the person(s) responsible for the operation of the company shall also be penalised by the same punishment, except where it is proven that such person did not collude in the commission of the offence or had made reasonable endeavours to prevent the occurrence of the offence. In this connection, under the SSA, failure to pay social security contribution at the rate as required thereunder could result in a criminal penalty of up to six months' imprisonment and a fine of up to THB 20,000.</p>
11.	Are the liability risks of the directors collective (i.e. the whole board is responsible/liable) or individual? On what grounds can a director exculpate themselves from other directors' acts or omissions?	Generally, the liability of the directors is collective, unless it can be proven that any director had no part in the commission of such offence.
12.	Are there specific actions against directors under bankruptcy law?	Please refer to our response in 2 under <i>Key Director's Liabilities in time of Financial Difficulties – The Bankruptcy Act</i> .



No.	Question	Answer
13.	Are there specific duties of (or consequences for) shareholders or other group companies at some stage of the financial difficulties, such as an automatic subordination or conversion into equity of debt to parent companies?	No, there are no specific duties of the shareholders or other group companies at the stage of financial difficulties of the company under Thai law.
14.	Is there special legislation mitigating the liability risks of directors specifically in view of the Covid-19 crisis?	No, there is no legislation in respect of the mitigation of the liability risks of directors in view of the COVID-19 crisis.



Contacts



Noparat Kaewringarm
Partner
Tel +662 263 7689
noparat.kaewringarm@allenoverly.com



Arthrit Hemara
Counsel
Tel +662 263 7683
arthrit.hemara@allenoverly.com



Vitita Subhawatt
Senior Associate
Tel +662 263 7617
vitita.subhawatt@allenoverly.com



Pimchanok Eianleng
Associate
Tel +662 263 7624
pimchanok.eianleng@allenoverly.com



For more information, please contact:

London

Allen & Overy LLP
One Bishops Square
London
E1 6AD
United Kingdom

Tel +44 20 3088 0000
Fax +44 20 3088 0088

GLOBAL PRESENCE

Allen & Overy is an international legal practice with approximately 5,500 people, including some 550 partners, working in over 40 offices worldwide.

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term **partner** is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings.

A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.