



Law Council  
OF AUSTRALIA

*Business Law Section*

**13 March 2019**

Senator Jane Hume  
Senate Standing Committees on Economics  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

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Dear Chair,

### **Treasury Law Amendment (Combating Illegal Phoenixing) Bill 2019**

The Insolvency and Reconstruction Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to provide a submission to the Committee's inquiry as to the Treasury Law Amendment (Combating Illegal Phoenixing) Bill 2019 (the **Bill**).

The proposed amendments are a significant step in advancing the Government's policy to address community and business concerns about the incidence of improper phoenix activity and will seek to reduce its harmful effects on the economy. The Committee has long advocated a need to increase regulation of pre-insolvency advisors and these amendments are a step in the right direction to tackle the complex problems posed by phoenix activity.

The Law Council previously made a submission dated 3 October 2018 to Treasury in connection with the consultation which occurred in connection with the exposure draft of the Bill. It is pleasing that it appears that some of the Law Council's suggested improvements to the Bill have been taken up in the final bill introduced to Parliament.

Although the Committee broadly supports the move to increase regulation of improper phoenix activity, several concerns remain about the wording of the proposed provisions.

#### **1. New voidable transaction**

- 1.1. The Committee supports the introduction of a new voidable transaction to address improper phoenix activity. The proposed provision offers benefits over the existing voidable transaction provisions that could cover improper phoenix activity, such as *Corporations Act 2001* (Cth) (**Corporations Act**) section 588FB and subsection 588FE(5), because there is no need to prove that an insolvent transaction has occurred. However, it is recommended that consideration be given to explaining how the proposed new provision may interact with existing state fraudulent conveyancing laws (such as *Conveyancing Act 1919* (NSW) section 37A).
- 1.2. The Committee supports the general approach of a new voidable transaction based on phoenix activity. The use of an effects test and reference to market value or best price is a commendable approach to designing criteria for use by liquidators in seeking to effect a civil recovery.

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- 1.3. The new wording of subsection 588FG(8) resolves the Committee's earlier concern about good faith restructuring efforts being caught which had arisen in connection with the exposure draft.
- 1.4. The Committee also commends the clarity which has been added to proposed subsection 588FG(9) since the circulation of the exposure draft.

## **2. Australian Securities and Investments Commission (ASIC) administrative recovery power (proposed section 588FGAA)**

- 2.1. The Committee supports the Government's proposal to make liquidator recoveries for creditors easier but does not support this proposed power on the basis that it raises multiple rule of law concerns by being too broad and arguably seeks to confer judicial power of the Commonwealth on ASIC.
- 2.2. The Committee notes that concerns about the similar *Bankruptcy Act 1966* (Cth) provision (**Bankruptcy Act**) (section 139ZQ) have also been raised in prior cases. In *Re McLernon; Ex parte SWF Hoists & Industrial Equipment Pty Ltd v Prebble*,<sup>1</sup> the court held that the section 139ZQ notice power given to the Official Receiver (**OR**) in Bankruptcy did not confer judicial power because the issue of the notice did not provide a final and determination of existing rights but rather conferred new rights that were subject to a de novo appeal by the court.
- 2.3. The proposed new section 588FGAA confers a broad discretion on ASIC as to whether to issue a notice (subsection 588FGAA(5)), and specifically limits ASIC's discretion if it believes that the court would not make an order (subsection 588FGAA(4)). Furthermore, ASIC may determine what it believes represents the benefits received by the person or fairly represents the application of proceeds of the transferred property. These are powers that are far beyond the powers conferred on the OR under the equivalent Bankruptcy Act provision. Furthermore, the Court may only overturn the notice if it determines that section 588FGAA does not apply (subsection 588FGAE(3)). In the Committee's view, these elements not only make the proposed new power inappropriate as being too broad, but render it open to a constitutional challenge for improperly conferring judicial power on ASIC.
- 2.4. Should the proposed power be retained, the Committee observes the inclusion in the provisions of a 3 year time limit, and commends this change, in the interests of consistency for liquidators, from the exposure draft.

## **3. Officer duty to prevent creditor defeating transaction**

- 3.1. The Committee is supportive of the Government's policy to target those involved in improper phoenix activity, including promoters and the unregulated pre-insolvency advisor market, however does not support the proposed amendments. In the Committee's view, the proposed amendments could constrain the market for good faith restructuring efforts and could be inconsistent with the existing policy that underpins the recently introduced safe harbour for directors in the Corporations Act section 588GA.
- 3.2. The proposed amendments would limit good faith restructuring to situations where a company continues to trade and does not enter external administration (or at least not for 12 months after the restructuring plan is implemented). This is because of

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<sup>1</sup> (1995) 58 FCR 391.

the combined effect of the proposed new 'creditor defeating disposition' provision in subsection 588FDB(1) (made voidable under subsection 588FE(6B)) and the new offence and civil penalty provisions that will apply to officers and those who procure transactions that are creditor defeating dispositions.

- 3.3. The Committee does not support the imposition of strict criminal liability for officers or for those who procure creditor defeating dispositions in subsections 588GAB(1) and 588GAC(1). The Committee also notes that the section 588GAB offences appear to be drafted in an overly complex manner which may make enforcement difficult. Further, there does not appear to be a great deal of difference between the conduct in subsection 588GAB(1) and 588GAB(2), although the former carries a term of imprisonment of 10 years while the latter is a civil penalty provision.
- 3.4. Entering into a transaction that is found to involve a creditor defeating disposition can lead to civil and criminal sanctions liability for officers involved (proposed section 588GAB) as well as for those advising them (proposed section 588GAC), including the possibility of a sentence of imprisonment. The Committee recommends that in order for criminal liability to arise, there be an additional criteria of proof of intention to improperly remove assets from being available from creditors, not unlike the difference in criteria that need be established to make out civil (subsection 588G(2)) and criminal (subsection 588G(3)) liability for trading whilst insolvent.
- 3.5. Furthermore, the imposition of criminal liability where a company ceases to carry on business as a direct or indirect result of a creditor defeating disposition could have a significant adverse chilling effect on genuine good faith restructuring efforts. Good faith restructuring will often involve shutting down unprofitable companies in a group structure. The inclusion of paragraph 588GAB(1)(d) and subparagraph 588GAC(1)(a)(iv) suggests that a company must be kept operating at some level for a minimum of 12 months after the asset transfer in order to avoid strict criminal liability. It is noted that a similar rule does not apply to civil liability in s588GAB(2)(a). The exceptions in subsection 588GAB(3) and subsection 588GAC(3) will require the company to be placed into external administration in order to effect the transaction. This is unnecessary and is likely to make good faith restructuring efforts more difficult and more costly, which could result in fewer businesses and fewer jobs being saved.
- 3.6. Individual company officers would be required to assess transactions to determine if they would contravene proposed section 588GAB. The Committee believes that this could create difficulties where company officers such as company secretaries are not taking part in management decisions but are merely actioning decisions to deal with assets made at a board or more senior executive level.
- 3.7. Furthermore, it may be difficult for officers to make clear decisions about whether subsection 588FDB(1) would be satisfied without obtaining a detailed legal opinion on each transaction.

#### **4. Director resignations**

- 4.1. The Committee is generally supportive of the proposed limitations on director resignations, which should deal with community concerns relating to directors backdating resignations to avoid liability. While this will not deal with current problems of directors appointing straw directors with little or no assets to replace them, it is better than the current system.

- 4.2. The Committee believes that directors have an obligation under their statutory duties to deal with a company's problems rather than simply resigning. The proposed changes will force directors to face up to the company's problems by appointing an external administrator rather than abandoning the company.
- 4.3. However, the Committee is of the view that nothing should restrict a director from resigning in circumstances where that director has proposed entry into administration (acting reasonably) but is in the minority and there are continuing directors. In those circumstances, it is proper that the director be permitted to resign.
- 4.4. The Committee also wishes to point out the difficulties that individual directors can have in resigning where they do not possess the company's Corporate Key needed to lodge forms electronically with ASIC. Consideration should be given to simplifying and streamlining this process.

## **5. Changes to Goods and Services Tax (GST) liability**

- 5.1. The proposed amendments would allow the Commissioner to serve director penalty notices on company directors to collect outstanding GST liabilities.
- 5.2. The recently enacted 'Safe Harbour' provisions require that in order to qualify a company must keep Business Activity Statement returns up to date, though payment is not necessarily required in order for the company to remain in the 'safe harbour'.
- 5.3. The introduction of Director Penalty Notices for GST liability will likely lead to directors receiving cautious advice which may contribute to the under-utilisation of the 'safe harbour'.

Should you require further information in the first instance please contact Peter Leech, Chair of the Insolvency and Reconstruction Law Committee ( [REDACTED] ).

Yours sincerely,

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**Chair, Business Law Section**