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Dear Mr. Hawkins,

RE: INQUIRY INTO CORPORATIONS AMENDMENT (PHOENIXING AND OTHER MEASURES} BILL 2012

Thank you for the opportunity to make a submission to the Inquiry into the Corporations Amendment (Phoenixing and Other Measures) Bill 2012 (the Bill).

This Inquiry comes post the Global Financial Crisis (GFC) a period which has recorded the highest number of corporate failures since ASIC collated the statistics.

The number of creditors affected by such a large number of corporate failures is reflected by the domino effect this has had on suppliers, in particular small and medium size businesses and the welfare of the communities they serve.

One corporate failure is not confined to the tax, employee and supplier liability of that corporation, it affects the secondary suppliers and in turn to their employees and creditors, to their families and to the welfare of their communities.

There are currently no statistics collected as to the actual impact corporate failures have on the Australian economy and the welfare of the community.

Putting aside the emotion, the disappointment that a supplier / creditors has to deal with, receivership is not a happy event.

Receivership is a last option, regardless of the protection provided by law there is a stigma, impact on the reputation and character of the people involved in the failed corporation.

The economic cycle unfortunately has winners and losers.

Corporations will fail; it is the natural order of economy. Whether the failure is design or opportunistic is essentially the issue.

The corporation is an ancient legal and commercial concept.

Much of the legal principles we enjoy today have taken over 400 years to develop, and for a reason. The principles mirror a need to provide a tool to manage risk, to encourage entrepreneurial activity.

The Inquiry provides a unique opportunity to examine the very reason why the law provides people with a privilege to incorporate a shield against risk.

The Inquiry also provides a valuable opportunity to review whether the current insolvency framework is efficient, fair, accessible, accountable and cost effective.

THE SOLOMON PRINCIPLE

The case of Salomon *v Salomon & Co* [1897] AC 22, is often regarded as the sacred pronouncement that a company is a separate legal entity from its shareholders and directors; therefore the people behind the company (directors and owners) are not personally liable for debts and obligations incurred by the company.

In the twenty first century, the risks to operate a business have increased exponentially, in contrast to the 19th century, but people's expectation has also changed dramatically since that time.

Historically, the concept of the corporation was Europe's answer to combine wealth and skill to embark on high risk trading ventures without exposing the personal assets of the shareholders and company officers.

The world has changed and perhaps the attitude of people who manage and own the corporation has also changed.

The sacred notion that a person can trade both in their name and in the company's name then claim the "style" that best suites them should no longer be available. In short the buck needs to stop with someone, but where its stops should be based on well-defined realistic principles, not necessarily more regulation, more red tape, and more onerous duties on the director.

Despite the voluminous and annual additions to the corporations' law to protect investors, shareholders, creditors, and the general public, even the insistence that corporate documents include an ACN number, there still appears to be a perception that there is wide spread abuse of the corporate privilege.

Perhaps it's not the law that needs to change. Perhaps Parliament may consider launching an education campaign to explain why the corporate entity is a privilege, a valuable economic tool, a concept that should be cherished used wisely and with honesty, this may be a more efficient use of resources than to create more regulation.

Increasing the range of personal duties on directors would ultimate erode the sanctity of the corporation perhaps even its relevance.

The Inquiry should ask, “What can be done to protect the stakeholder without eroding the relevance of the corporation? “How can we produce the policy outcome without increasing the burden”.

Creating more laws and regulations should not be the automatic default position.

PHOENIX COMPANY ACTIVITY

Phoenix company activity involves the liquidation of a corporation leaving creditors out of pocket, including the ATO, employee entitlements and suppliers only to find the same or similar business set up in a new corporate entity usually by the same people behind the failed corporate entity.

Creditors not surprisingly find this exercise fraudulent.

This situation is compounded when the receiver – liquidator is appointed by the directors which not surprisingly create suspicion in the mind of the creditors which in itself is a good cause to examine the reform of the insolvency sector beyond what has been proposed in recent times.

The Parliamentary Joint Committee on Corporations and Financial Services had examined phoenix companies in particular those who appear to have used this aspects of the law to enrich themselves.

The corporate entity is not a right it’s a privilege designed predominantly to manage risk.

The privilege is abused when the same people who controlled the entity which failed, buy the assets at substantial discounts (i.e. fire sale) to set up another corporation to operate the same or similar business.

Phoenix activity appears to exploit the privilege of limited liability. People who engage in such activity have little or no respect for the efforts employed to create this tool of commerce and law and do not understand that their actions will ultimately bring in further regulation perhaps even the demise of the corporation as we know it.

The concept of limited liability is critical to manage risk, promote the creation of opportunity, wealth, markets, and innovation.

Had it not been for the corporation technological advancements in science, our high living standards, the things we take for granted would not likely have been accessible if possible at all had it not been for the corporate entity and concept of limited liability.

When controllers of the corporate entity exploit the corporate veil to engage in less than honest activity, although perhaps legal, it seriously challenges the very essence of why we have this legal and business tool in the first instance.

Contrary to what appears as popular belief, phoenix activity is neither always apparent nor easy to detect or the norm.

In commerce, there are always external events which impact a business including internal factors from theft, to employees taking client files, goodwill, and other property which may lead to corporate failure.

A regulator will need to be sensitive, realistic and prudent when deciding which activity falls within this scope of phoenix activity, and balance the interests of many stakeholders including public policy objectives**.**

Further proposed reforms to improve the operation of Australia's insolvency system foreshadowed in the Government's Proposals paper *Modernisation and Harmonisation of the Regulatory Framework applying to Insolvency Practitioners in Australia,* will also improve the regulatory framework to address phoenix activity.

THE BILL

The Bill proposes to amend the *Corporations Act 2001* (Corporations Act) , by creating the power to administer the winding up of companies so that possible phoenix activity can be investigated. The Bill's objective is to assist the payment of unpaid employee entitlements from the General Employee Entitlements Redundancy Scheme (GEERS) in cases were a company has been abandoned.

ASIC may currently apply to the Court for a company to be placed into liquidation, likewise employees, as any other entitled creditor, can apply to the Court to liquidate a company.

The proposed power to ASIC to wind up an abandoned company appear to be designed to limit if not remove judicial review for the appointment of a liquidator to an abandoned company.

This will enable ASIC to appoint a liquidator to investigate and report on a range of matters beyond possible phoenix behaviour.

Currently the receivers need to find the funds to finance such action. Asking creditors who lost their money to find more money to finance such investigations speaks for itself.

It should be noted that the powers proposed is in relation to when directors abandon the company and don't place it into liquidation.

A director need not abandon a company because they are engaged in phoenix activity. The proposed implied assumption in law is perhaps stretching commercial reality and placing unreasonable onus on directors.

In any event, ASIC appointed liquidator would be able to examine and take action in relation to voidable transactions under Part 5.7B, Corporations Act which cannot be used for the benefit of creditors.

The Bill will assist employees to access the General Employee Entitlements Redundancy Scheme (GEERS) only in so far that the company falls within the category to create the entitlement for the employees. This could also have been achieved by changing the definition of when the entitlement to GEERS occurs rather than inserting this in a corporation law.

Recommendations

1. DEFINING FRAUDULENT PHOENIX ACTIVITY

There needs to a clear unambiguous definition of 'fraudulent phoenix activity" or rely on the common law definition of "fraud".

There is currently no definition of what constitutes 'fraudulent phoenix activity'.

No doubt this will be open to extensive judicial review.

In effect it also provides the basis to give arguable, excessive powers to the regulator.

The type of behaviour the Bill is to address is relatively well know, so why not clearly define it?

The proposition that this phoenix activity may come in many forms, and over time the technique may change, it is argued that the outcome and intent to engage in such activity is unlikely to change. It has been going on since at least the 1880s, not much has changed.

The Bill has been drafted to capture a range of behavior /activity which ideally should be open to Parliamentary scrutiny.

There is some concern that either the drafting was conducted to capture as much as possible, or to provide extensive powers to ASIC.

Both of these policy outcomes are outside the focus of the exercise to deal with a specific type of behaviour, a well-known and defined type of behaviour /activity. The concern is to an extent supported by other changes to the corporation law which appear to illustrate a trend. For instance the proposed changes to the range of penalties for directors, found in the Tax Laws Amendment (2011 Measures No.8) Bill 2011, and the release of the exposure draft of the Corporations Amendment (Similar Names) Bill 2012.

Although fraudulent activity should be considered a criminal rather than strictly a corporation law issue, it is rightly considered as an abuse of the privilege of limited liability.

It should be noted there is law in every state jurisdiction and the Commonwealth which makes it unlawful to procure a benefit by deception, using a corporate entity. Although the evidential threshold is high, the principle is in place and provides a good starting point to deal with any "fraudulent" use of the body corporate.

2. POWERS TO ASIC

The proposed increased powers to ASIC appear to apply more broadly than to fraudulent phoenix activity, and may become the basis of fishing or other exploratory behaviour.

If the intention of the Bill is to deal with phoenix behaviour, then the Bill requires careful review to limit such powers and the use of such powers.

The Bill in its current form may provide an opportunity to delve into matters and affairs of directors which are likely to be counter-productive and increase the burden of further compliance.

If such powers are to given then there needs to accessible, fair, transparent and efficient review of such powers.

ASIC currently has the power to bring a corporation back to life in accordance with s 601AH Corporation Act and can do so with judicial review. This judicial review should continue.

In such a situation the Bill proposes that ASIC can order the winding up a company. ASIC 's powers to reinstate then wind up a company strictly on fraudulent phoenix activity is accepted, as noted earlier, but such powers may provide an opportunity to examine other unrelated matters.

If the Bill is designed to deal with fraudulent phoenix activity and protect employee and related entitlements this should be clearly defined and the power limited to that issue otherwise there must be judicial review every time such powers are exercised by ASIC.
In its current form there is a foreseeable problem posed by the Bill, by giving such wide ranging powers to the regulator without accessible transparent and efficient review.

If the Bill is intended to empower ASIC with such powers this must be made clear in both the report and there should be careful examination why such powers are need and for what reason. If the powers proposed by the Bill address other related issues, then the Bill should be the subject of analysis, scrutiny and debate.

3. MORE REGULATION

The Corporations Act has been the subject of annual review and amendments, often in an ad hoc, fragmented manner, the result is more regulation, more powers to the regulator, more laws.

The question should be asked is whether changing the law achieves anything measureable?

Will there be less 'fraudulent phoenix activity" because the law changed or because of other factors.

Is changing the law the path of less resistance, or can another path be considered.

This annual ritual to amend the Corporations Act is having an impact on business, which the Committee and legislature must consider.

Protecting the victims, the revenue base of the ATO is a legitimate and important policy outcome, changing the rules without measuring the bottom line impact may not be the most efficient response to this issue.

As the Corporations Act is once again amended, there is an increase burden for the majority of directors to become familiar with ever complex and technical legal principles, procedures, regulations and this will ultimately lead to not only higher costs for business it also creates barriers to the market for those wishing to embark on setting up a new business. Ultimately someone needs to manage the corporation, someone needs to pay the cost of regulation and someone needs to create the opportunities, the jobs and the economic activity vital for the welfare of the community.

Introducing more powers more laws, is not necessary the end of the issue.

There should be a thorough impact study each time this legislation is amendment.

The justification for any changes to the Corporations Act should be set at the highest possible threshold, and not every issue which arises within the regulation of corporations need be dealt with by more regulation.

Yours sincerely,

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