



Association of Independent Insolvency Practitioners
By the practitioner, For the practitioner

20 March 2019

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

Sent via email: economics.sen@aph.gov.au

Dear Committee Members

Re: Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019
[Provisions]

We are pleased to make a submission on this important topic.

AIIP is a professional organisation that was established by insolvency practitioners to assist fellow practitioners meet the challenges prevailing in the profession. AIIP was formed in 2016 and it now has 160 members. It is the only professional insolvency practitioner association which requires its members to be either registered liquidators or registered trustees in bankruptcy. Its members primarily practice in the small to medium enterprise (SME) market.

*The AIIP members are highly skilled and trusted professionals with professional indemnity insurance and have extensive experience in managing formal administrations where what is to be known as a **Creditor-Defeating Disposition** (“CDD”) has occurred prior to our appointment.*

1. Key Points

AIIP supports all of the four proposed initiatives in the Draft Bill.

The CDD steps will provide a useful addition to a Liquidator’s “tools” to combat illegal Phoenixing and CDDs; and has been well considered and structured.

For example, the presumption that the CDD is not for market value where the company has inadequate records is helpful.

However, in most Liquidations where it is apparent that a CDD has occurred, the Liquidator has limited or no funds available to them and consequently the new provisions will not be used by them.

Additionally ASIC will face evidentiary road blocks to enable Administrative Orders to be issued.

We recommend that additional steps be implemented to address the current market failure and to enable the legislation to work in practice. These recommended steps will assist both insolvency practitioners and ASIC to achieve successful outcomes.

The legislation is framed as a new voidable transaction recovery for Liquidators or as an Administrative Order by ASIC. In practice, however, there is a need for a commercial catalyst to enable CDD transactions to be addressed in a timely manner and also to provide the groundwork for subsequent voidable proceedings or Administrative Orders where necessary.

We also make recommendations in regard to ASIC and the ATO which are detailed below.

We will be pleased to expand on these current recommendations at a convenient time to you.

2. Commercial Catalyst

The Bill must additionally provide for:

- Immediate Compulsory Examinations;
- Funding of Liquidators shortly after commencement; and
- Penalties for non-compliance with Examinations.

We expand further how this low cost and speedy Examination procedure can be implemented to operate in addition to the existing expensive, and less timely court examinations.

Without an immediate examination, the elements to obtain a successful recovery such as determining “the best available price” and whether a disposition has actually occurred are unlikely to be able to be proven.

3. ASIC and ATO

Currently, ASIC rarely funds liquidators therefore small and medium enterprise Directors do not perceive any risk of being challenged by the regulator.

Unless ASIC has adequate funding for CDD matters, there is likely to be little impact from ASIC actions in practice from the new provisions.

If our recommendation for ASIC to make early funding available to Liquidators is implemented, ASIC must establish simple Criteria such that Insolvency Practitioners can submit funding applications easily. Many Liquidators are disengaged with the

existing ASIC Assetless Administration Fund because the processes to submit funding applications are time consuming and applications often get rejected.

The Australian Taxation Office (“ATO”) needs to take a more commercial approach to funding liquidators and should establish protocols to jointly manage funding to liquidators with the Department of Jobs which manages the Fair Entitlements Guarantee (“FEG”) recovery program. Both organisations are priority creditors in insolvencies and the Australian Taxation Office is also usually the most substantial unsecured creditor.

Currently, insolvency practitioners cannot engage directly early in an administration with either ASIC or the Australian Taxation Office.

Therefore ASIC and the ATO need to establish a “Relationship Model” of managing insolvencies.

4. Current Market Failure

A Liquidator is effectively powerless to act immediately if a Director refuses to hand over a business which the Liquidator believes to still be owned by the Company in liquidation.

Without funds at the start of a Liquidation, the Liquidator would need to risk his or her personal assets to commence legal proceedings and must give a Court undertaking to pay Damages in order to obtain an injunction. Therefore, the Liquidator cannot force a resolution.

Furthermore, if the Director claims that the Business has been sold, it is usually difficult to get evidence of the sale in a timely manner. Even if the Director admits that he or she cannot provide substantive documents, the Liquidator still cannot easily take action for the same reasons as mentioned above.

As time passes, the Liquidator may continue to have limited information and is potentially open to criticism for not protecting the company’s perceived assets. This places the Liquidator in an untenable position.

Although the *Corporations Act 2001* states the Liquidator doesn’t need to carry out more than certain regulatory tasks when the Liquidator is unfunded, in practice, a Liquidator is forced to continue trying to obtain information and the co-operation of the Director often without real success.

Considerable unpaid Liquidator’s time is usually spent on matters where a CDD has been identified often without an early resolution. It is not unusual during the first two months of a CDD matter for up to \$50,000 of unpaid fees being incurred by a Liquidator.

Conversely the Director does not face any immediate threat and therefore has no incentive to cooperate. ASIC's actions to assist the Liquidator may take several months to get into Court and penalties are often minimal. A solicitor is likely to advise the Director that the Liquidator will continue to be unfunded, and therefore a low settlement offer can be made which may need to be considered as it may be commercially acceptable to the Liquidator.

5. The Benefits of Early Intervention

Quite often the CDD Phoenixing occurs either just before or even after the date of Liquidation. Importantly, it takes time to obtain third party consents etc. to effect a transfer of a business and this creates a limited window of opportunity for a Liquidator to challenge a purported transfer.

The focus therefore needs to be on finding a way to reach a settlement or sale with some clarity for the parties before the business is destroyed, on-sold to another related party, and/or costs escalate.

At an early stage in the liquidation, directors of phoenix companies may be able to be convinced to obtain certainty of their control of the business by making a payment to a liquidator rather than following the advice of an unqualified adviser to simply hide the facts. For honest directors who may have received poor advice this creates an opportunity for them to retrieve the position to some extent.

We attach an annexure setting out typical CDD Phoenixing Scenarios. Our "Commercial Catalyst" recommendation is useful in each of these examples.

6. Immediate Compulsory Examinations

A liquidator can currently only ask a director to attend a meeting. At the meeting the Director can control what information is divulged and may only give "lip-service" to this duty or not attend a meeting at all.

We therefore recommend that immediately after a liquidation commences in a Phoenix situation that a low cost formal examination be conducted at the Offices of ASIC. The Liquidator could conduct the examination, but with an ASIC Officer present and follows a formal procedure. This may be similar to the process contained within Section 77C of the Bankruptcy Act 1966. This section allows the Official Receiver to issue a notice to a person to attend to the Official Receiver to give evidence and the transcript is then able to be used in any other proceedings.

Formal Notices to attend to be served by ASIC with lists of specific documents relevant to the Phoenixing of the ongoing business operations being required.

A transcript to be signed by the examinee afterwards.

Directors and relevant third parties who may be in possession of a business or able to exert some form of control, e.g as head contractor or landlord, etc be required to attend. Furthermore, if a Liquidator can show that a person who is not registered as a Director is able to exert control, e.g. as a Bank Signatory, then they must also attend an Examination. Where appropriate, an unregulated insolvency adviser should also be examined.

Consequently the onus will be placed on examinees to provide truthful explanations and documents that can be used in subsequent litigation.

If parties fail to attend, then significant penalties should automatically apply

The Benefits of an Early Examination will be:

These steps will move the “goal posts” in favour of the Liquidator taking control of the situation rather than letting the Directors and their advisers dominate and obstruct. At present a Liquidator has few levers!

Rapid Clarification of the Facts

- 6.1 To promote early negotiations with relevant stakeholders;
- 6.2 To find out if a disposition of a business has actually occurred or not; and
- 6.3 The values of most Phoenixed assets cannot be easily established

Therefore, an examination will enable information to be obtained to establish the Best Available Price of a Business (perhaps) for subsequent litigation

Consequently ASIC will be able to issue more Administrative Orders with knowledge of the facts and a well-founded estimate of compensation. Liquidators will similarly have better information.

During the examination the new CDD Legislation will be explained to the stakeholders and is therefore a useful tool to encourage negotiations.

The identity of third parties can be discovered and they also can be examined. For example after a tax garnishee is paid out, many companies continue to use the same ABN etc. but bank funds into a third party bank account.

Where the Company has debtors due to it, a Liquidator can bank those proceeds if the information becomes available during an Examination. However, it may be difficult to recover these funds later by pursuing them through a CDD Recovery Action or any of the other voidable transaction provisions.

7. Previous Senate Construction Inquiry – Phoenix Activity

There has been a previous inquiry into “Insolvency in the Australian Construction Industry” released 3 December 2015 by the Senate Economics References Committee.

https://www.aph.gov.au/parliamentary_business/committees/senate/economics/insolvency_construction/Report with considerable commentary about phoenix activity.

That report profiled the collapse of Walton Constructions and the abundance of phoenix activity in the building and construction industry, and particularly, the fundamental flaws embedded in that industry which forces subcontractors to bid for work without quoting for on-costs such as superannuation, PAYG, GST to be competitive. Not only is the report an interesting and easy read, it remains relevant today to explain the principal reasons for phoenixing in the building and construction industry and the remedies to mitigate it.

For the building and construction industry, and the economy generally, the opportunity for liquidators to conduct quick and inexpensive public examinations will mitigate phoenix activity.

8. Enabling Phoenix Investigations

In the Phoenix environment legislation should be enacted to provide:

- 8.1 ASIC Searches payable only on receipt of assets in the administration
- 8.2 Bank accounts - Free & Rapid (within two business days) Online View & CSV (comma-separated values file) Download Access to Bank Statements and Bank EFT Vouchers
- 8.3 Immediate Access to Cloud & Other Accounting Data Files free of charge and for the duration of the administration, with provision of any passwords/password reset needed for access.

9. Pre-Insolvency Advisors

The pre-insolvency industry is unregulated. This submission does not address that issue, however our recommendations would contribute to mitigate their Phoenix activity.

10. ABN Reforms

We note other steps are being taken to improve and tighten the ABN system.

Currently the ABN system is exploited by Phoenix operators and we encourage these and further reforms.

11. Conclusion

The Author of this Submission, Bruce Mulvaney (AIP Committee Member)(email: [REDACTED]) and myself will be pleased to discuss our submission further with you.

Yours faithfully

[REDACTED]

Stephen Hathway
President

Annexure

Typical Phoenix Scenarios

Phoenixed Companies often involve:

An alleged prior Informal Transfer of a Business perhaps to a Related Party, but no or few documents are available

Continued use of the Company's ABN, but claimed to be an "oversight"

A related or third party who is in a Position of Control, perhaps as the key customer, a Landlord or Franchisor.

A Tiered Sub-Contracting Structure, where the phoenixed company has no physical assets and its operations have been or will be taken over by a new entity

Books & Records incomplete or non-existent, perhaps not entered for several months or years; Tax Returns etcetera not lodged ;Transactions mixed between entities – "Robbing Peter to Pay Paul"

In Retail Businesses significant Cash is never Banked & therefore it is almost impossible to determine the true profitability and value of a business

Large unexplained Cash Withdrawals from bank Accounts

Operating Totally outside of the Taxation System