



27 April, 2012

Mr Tim Bryant
Committee Secretary
Senate Economics Legislation Committee
P O Box 6100
Parliament House
CANBERRA ACT 2600

Dear Mr Bryant

INQUIRY INTO CORPORATIONS AMENDMENT (PHOENIXING AND OTHER MEASURES) BILL 2012

Thank you for your letter dated 22 March 2012 addressed to Dr Martin Parkinson, Secretary of the Treasury, inviting him to make a submission to the Inquiry into the Corporations Amendment (Phoenixing and Other Measures) Bill 2012 (the Bill).

Business failures are a natural and expected phenomenon associated with dynamic market economies and entrepreneurial risk. Although business failures may involve negative outcomes for affected parties, they can also provide opportunities for productivity growth where resources can be successfully deployed to more efficient and better uses. An efficient insolvency framework facilitates structural adjustment following business failures by providing a fair and orderly process to deal with the financial fallout of insolvent companies that balances the competing interests of all affected parties and minimises potential market distortions that may arise.

In that context, Government insolvency policy seeks to strike a balance between encouraging entrepreneurial risk and stopping dishonest conduct, such as phoenix activity. While the characteristics between a legitimate business failure and a 'phoenix type' business exit may not always be readily discernible, legislation to address the latter should not deter entrepreneurs from engaging in legitimate business activity which includes company formations and liquidations. This legislation is instead designed to target illegitimate phoenix company activity.

PHOENIX COMPANY ACTIVITY

Phoenix company activity (phoenix activity) involves the intentional abuse of the corporate form to evade unpaid tax and other liabilities such as employee entitlements through the deliberate, systematic and sometimes cyclic liquidation of companies. Typically after a company is liquidated, a new company commences trading using some or all of the assets of the liquidated company; the liquidated company is left an assetless shell and may be wound up by its creditors who receive little in the liquidation. The new company, which sometimes bears a similar name to the liquidated company, is commonly controlled by the directors or controllers of the failed company, or parties related to them. When this process occurs with the intention of avoiding paying creditors, rather than as a result of legitimate business failure – this represents phoenix activity. Often the process is repeated leading to further losses for creditors – where offenders purposely structure their operations in order to engage in phoenix activity and avoid detection.

The Parliamentary Joint Committee on Corporations and Financial Services has considered the problem of phoenix companies and expressed particular concerns about people who repeatedly engage in phoenix activity.

Phoenix activity exploits the privilege of limited liability inherent in the corporations law, which seeks to ensure that when a company fails, those behind the company (directors, shareholders) are not ordinarily liable for the company's debts. While the concept of limited liability is important in supporting risk taking and wealth creation in market economies, some potential for moral hazard exists when directors exploit the corporate veil to engage in dishonest activity.

As phoenix activity can take a number of forms within a corporate structure, it is often difficult to detect. As such, to effectively combat phoenix activity, regulatory tools need to be both broad based and flexible to enable the early detection of phoenix activity and to minimise the adverse impacts for stakeholders, such as creditors, employees and consumers. This underpins the Government's broad policy strategy to address phoenix activity mirrored in this Bill.

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 enhance the regulatory framework to address phoenix activity. An overview of existing and proposed corporation law measures designed to address phoenix activity is provided at [Attachment A](#) for the assistance of the Committee.

CORPORATIONS LAW AMENDMENT (PHOENIXING AND OTHER MEASURES) BILL 2012

The Bill amends the *Corporations Act 2001* (Corporations Act) primarily to introduce an administrative process for the winding up of companies to investigate possible phoenix activity and to facilitate payment of unpaid employee entitlements from the General Employee Entitlements Redundancy Scheme (GEERS) where a company has been abandoned.

Currently, ASIC has no power to administratively place a company into liquidation, but must instead apply to the Court for a company to be placed into liquidation. Employees, as creditors, can also apply to the Court for a company to be placed into liquidation.

The Bill introduces an administrative power that ASIC may use to wind up an abandoned company, rather than applying to the Court for the company to be placed into liquidation.

This power will facilitate the:

1. appointment of a liquidator to an abandoned company;
 - Providing ASIC the power to place abandoned companies into liquidation will facilitate the appointment of a liquidator to investigate and report on alleged misconduct related to possible phoenix behaviour; or to investigate and take action in respect of uncommercial transactions entered into by the company's directors prior to deregistration or abandonment of the company. For companies that have been deregistered, the Bill provides ASIC with the power to reinstate these companies and then place them into liquidation.
2. commencement of legal proceedings for voidable transactions (if appropriate) for the benefit of creditors;
 - At times, directors abandon their companies and do not place them into liquidation. This could include circumstances where directors have engaged in phoenix activity. Where the company is not placed into liquidation, the voidable transactions provisions in Part 5.7B of the Corporations Act cannot be utilised for the benefit of creditors.(see Attachment A)
3. payment of any entitlements that workers have under GEERS.
 - The Bill will assist employees to access the General Employee Entitlements Redundancy Scheme (GEERS). Employees can be denied access to GEERS, where a company fails and it is

not placed into liquidation. This includes when companies are abandoned by their directors. Currently, only a Court has the power to place an abandoned company into liquidation. Estimates of the current stock of abandoned companies that may be wound up by ASIC are included in the ASIC submission to the Committee.

Separately, the Bill also includes a regulation making power to prescribe methods of publication of notices relating to events before, during and after the external administration of a company.

The Bill also removes the publication and gazettal requirements for external administration notices from the Corporations Act and replaces them with a requirement to publish in the prescribed manner, which will facilitate replacing the current requirements with online advertising via an ASIC insolvency notices website. The website is scheduled to commence on 1 July 2012. The costs for stakeholders to place advertisements on the ASIC Insolvency Notices website will be significantly less than the cost of the current requirements to advertise in the print media.

Please do not hesitate to contact the Treasury if there are matters that you require assistance or clarification on. Treasury's contact officers on this matter are Alix Gallo (6263 2870) and Andrew Hall (6263 3927).

Yours sincerely

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ATTACHMENT A: EXISTING AND PROPOSED CORPORATION LAW MEASURES DESIGNED TO ADDRESS PHOENIX ACTIVITY

A. EXISTING CORPORATIONS LAW PROVISIONS TO COMBAT PHOENIX ACTIVITY

Part 5.7B of the Corporations Act 2001 contains a number of remedies to assist creditors affected by phoenix activity once a company is placed into liquidation.

The corporations law mechanisms available to increase the returns to creditors include the voidable transactions provisions, which can be used by liquidators to challenge uncommercial transactions (s. 588FA and 588FB), unfair loans (s. 588FD), unfair preferences (s. 588FA) and unreasonable director related transactions (s. 588FDA).

Part 5.8A of the Corporations Act also contains provisions rendering a person liable to compensate for loss of employee entitlements where an arrangement or transaction is entered into for the purpose of avoiding the payment of those entitlements. Directors can also be disqualified administratively by ASIC in limited circumstances (s. 206F) and by the Court (s.206D).

In addition, it may be possible to bring actions for damages for breach of director duties and breaches of insolvent trading laws. Liquidators are obliged to report suspicions they have about corporate misconduct to the regulator (s. 533 and 438D of the Corporations Act).

In this context, the Bill seeks to augment these measures in combatting phoenix activity by providing the Australian Securities and Investments Commission (ASIC) with an administrative power to place companies in liquidation. Once a liquidator is appointed by ASIC, they will be able to investigate the corporate collapse and to commence any legal actions against directors that may be available for the benefit of creditors. The liquidator will also be able to apply for funding from the Assetless Administration Fund to investigate possible breaches of the law. Both the appointing of a liquidator to investigate the company collapse and the commencing of legal actions against directors for a breach of their legal obligations will act as deterrents to those engaged in phoenix activity.

B. OTHER PROPOSED REFORMS

Corporations Amendment (Similar Names) Bill

As part of the Protecting Worker Entitlements package election commitment, the Government announced that it would introduce legislation to impose personal liability on a director for the debts of a similar named company to a failed company, that the director was also a director of. This measure is aimed at addressing phoenix activity which involves using companies with similar names.

The Government released draft legislation in December 2011 for consultation and is currently considering the submissions received as part of those consultations.

Insolvency Reform Proposals

On 14 December 2011, the Government released a package of reform proposals to improve the operation of Australia's insolvency system through the proposals paper: *Modernisation and Harmonisation of the Regulatory Framework applying to Insolvency Practitioners In Australia* (see <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2011/Reforms-to-Modernise-and-Harmonise-Insolvency>).

Specific enhancements to the regulatory framework to address phoenix activity include:

a) Director Suspension Notices

This reform would allow ASIC to suspend directors or company officers who fail to lodge a report as to company affairs (RATA) when requested by ASIC, or fail to lodge the company's books and records following a demand by a liquidator; and who do not have a reasonable excuse for non-compliance. ASIC would be required to file a notice of suspension on the public record. Upon being recorded on the public register, the director would be prohibited from managing a company. When directors engage in phoenix activity, they often do not comply with their existing legal obligations. If served with a suspension notice, this measure would prevent these directors from continuing to act as a director of a company.

b) Assignment of Actions

A liquidator may assign statutory rights of action arising out of the Corporations Act that vest with him or her (or the company) during an administration, to a third party. Currently, the liquidator is the only person who can commence statutory actions. In circumstances where the liquidator is unwilling to commence legal proceedings, this reform would permit others to commence statutory legal actions to be taken against directors who have breached their legal obligations, such as when assets are transferred illegally from a failed company in cases of phoenix activity.

c) ASIC Information Gathering Powers

This reform proposes to clarify and enhance the ability of ASIC, the Department of Employment, Education and Workplace Relations (DEEWR) and the Insolvency Trustee Service Australia (ITSA) to gather and share information. Increased information sharing between regulators is expected to lead to a more coordinated approach to investigations and legal actions involving phoenix activity.

d) Assetless Administration Fund (the AA Fund)

On 14 December 2011, the Government approved an extension of the permitted uses of the AA Fund to include funding activities undertaken by insolvency practitioners directed against phoenix activity or breaches of officer's duties that impact upon employees, consumers or small businesses.

The AA Fund administered by ASIC was established to provide an enforcement program targeting misconduct by officers of assetless companies, who are often involved in repeat phoenix activity.