Submission to Senate Economics Legislation Committee: Inquiry into Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019 [Provisions]

DETAILS OF PARTIES MAKING THE SUBMISSION

1) This submission is made on behalf of Mendelsons National Debt Collection Lawyers Pty Ltd ACN 125 099 701 (**Mendelsons**) and Prushka Fast Debt Recovery Pty Ltd ACN 005 962 854 (**Prushka**).

2) Mendelsons is the in-house law firm of Prushka and it focusses on debt recovery and insolvency in all Australian jurisdictions, specialising in commercial debt collection.

3) Prushka has a 43 year history and handles debt collection work for over 57,000 businesses across Australia, mostly being SMEs but also for larger corporate clients. Prushka acts on the No Recovery – No Charge basis.

4) This submission is written by Roger Mendelson, Principal Lawyer of Mendelsons and CEO of Prushka and Alison Lee, Special Counsel and Practice Manager of Mendelsons.

INSOLVENCY LAW REFORMS

5) We have provided a submission at each stage of the consultation process relating to the Government's insolvency law reforms.

6) We refer to and re-iterate each of those submissions as if they were set out hereunder and attach them herewith marked 1, 2, 3, and 4 for ease of reference.

THE BILL

7) As stated in the Explanatory Memorandum, illegal phoenix activity ranges from the opportunistic to the systemic, with the most common characteristic of such activity being the stripping and transfer of assets from a company to another entity with the intention of defeating the interests of the first company's creditors in that company's assets.

8) Our view is that overall, the legislation targets the systemic illegal phoenix activity that occurs on a larger scale. The smaller and more opportunistic types of phoenixing activity will, perhaps inadvertently, escape the ambit of the legislation.

9) We have and continue to come across many companies on a daily basis that:

- Are registered;
- Are seemingly a "shelf company" in that it does not trade nor does it hold any assets;
- Obtain goods and/or services for a significant value in the name of the company and do not pay for them;
- Have seemingly been registered solely for the above purpose;
- Do not pay the annual ASIC fees or attend to lodgments, leading to the natural deregistration of the company in due course.

10) A case example on a de-identified basis is provided below:

- ABC Pty Ltd was registered on 11 May 2017.
- On or about 22 May 2017 and 16 August 2017 ABC Pty Ltd entered into contracts with a telecommunications company to obtain mobile phones, ipads/tablets and accompanying data and usage plans.
- From the day that ABC Pty Ltd obtained the goods and services, it did not pay anything to the telecommunications company as required under the contracts for those goods and services.
- The total amount owing to the telecommunications company by ABC Pty Ltd under each of the contracts remains in the sum of $255,568.90.
- The director of ABC Pty Ltd has disconnected all [last] known telephone numbers and has been unresponsive to all other forms of contact.
- Unless the telecommunications company (or other creditor) takes action that leads to an adverse record on a public register against ABC Pty Ltd, no one will be the wiser as ASIC will deregister ABC Pty Ltd when its annual fees are not paid and/or annual returns are not lodged. The director will simply set up another company to do the same thing as they will not be prevented from doing so.

11) We see the likes of ABC Pty Ltd regularly together with the entities that are established by the same officeholders either at the same time or following the deregistration of each of them.

12) The legislation does not immediately target the opportunistic behavior as we have described above. Such actions do not have the obvious hallmarks of illegal phoenix activity that involves the stripping and transfer of assets from one entity to another and/or external administration, although they can cause great distress to creditors, particularly to SMEs.

13) As the officeholders of such entities are also unlikely to provide personal guarantees, there is also no immediate ability for a creditor dealing with such a company to seek any recourse from the director personally.

14) Furthermore, as the sort of company described does not trade at all, it is not going to:

- Come under the scrutiny of the ATO;
- Fit within various tests provided in the legislation and the use of timeframes such as '12 months prior to the company ceasing to carry on business altogether';

to allow the company to be exposed by the provisions of the legislation via other avenues.

GENERAL

15) We welcome the global intent of the Bill and the activity that it seeks to target. This position, however, is qualified by the comments made in our previous submissions and the further comments made herein.

16) The Bill will do nothing to help SMEs deal with opportunistic phoenixing, which we see is a far greater problem.

17) Larger corporates employ credit professionals and are likely to either reject an application for credit or require guarantees from directors. SMEs on the other hand are much more likely to take a new customer on face value.

18) Our submission dated October 2017 (annexed hereto and marked 1) refers to our proposal for setting up a Statutory Demand Register. We believe that this would significantly reduce the incidence of losses from opportunistic phoenixing.

19) The same submission details our proposal for Solvency Statements. Again, this would be easy to set up, cheap to administer and would dramatically reduce phoenixing losses.

20) There is room to improve the outcomes from deregistration, as detailed in paragraphs 35-44 of the same submission. At present, ASIC processes inadvertently assist opportunistic phoenix operators to continue the process of setting up further companies.

SUMMARY

21) We welcome the changes but they don't go far enough in tackling opportunistic phoenixing.

22) Our proposals would be easy to implement and would seriously undermine the major problem of opportunistic phoenixing.

Date: 14th March 2019

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Submission to the Minister for Revenue and Financial Services in relation to anti-phoenixing legislative proposals.

DETAILS OF PARTIES MAKING THE SUBMISSION

1) This submission is made on behalf of Mendelsons National Debt Collection Lawyers Pty Ltd ACN 125 099 701 ('Mendelsons') and Prushka Fast Debt Recovery Pty Ltd ACN 005 962 854 ('Prushka').

2) Mendelsons is the in house law firm of Prushka and it focusses on debt recovery and insolvency in all Australian jurisdictions.

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4) This submission is written by Roger Mendelson, who is Principal Lawyer of Mendelsons and is CEO of Prushka.

COMMENT ON PHOENIXING ACTIVITY

5) Due to the large number of debt claims handled by Prushka, it has exposure to phoenixing activity at close quarters. Due to the large client base, it is common for more than one client to have outstanding debts owed by one corporate debtor.

6) As a general observation, we believe that fraudulent phoenixing activity, although significant in terms of tax revenue loss, is not significant in terms of corporate debts being unpaid.

7) Fraudulent phoenixing is very much focused on retaining funds otherwise due to the ATO, such as individual tax retention and GST and normally relates to failure to fully remit amounts due under the BAS system.

8) Such activity is clearly illegal and criminal and there are probably sufficient measures in place to counter such activity, although what has been lacking is the allocation of resources to do so.

PROPOSALS

9) We support the idea of Director Identification Number (DIN) because it will certainly make it easier to track directors and will act as a means of deterrent for directors who are serially

operating companies which will ultimately fail. The impact will be similar to the introduction of the ACN, which made it much easier to track companies.

10) However, most of the recommended provisions are aimed at protecting tax revenue, rather than the rights of other creditors.

11) The ATO has significant priority rights as opposed to other creditors, through processes such as the Director Penalty Notice, which in many cases allows the ATO to make claims directly on directors of failed companies for unpaid tax liability.

12) Processes to protect the tax revenue are in most cases detrimental to other creditors because priority payments to the ATO result in less available funds for other creditors.

PROBLEMS FACED BY SMEs

13) By far the greater problem faced by SMEs is in dealing with debtor companies which are essentially under-capitalized and which in many cases are simply doomed to fail, due to lack of business experience and, in many cases, a business model which is unlikely to be successful. These companies survive for a period of time by the directors taking out funds on which to live and by then juggling creditors and BAS obligations. In most cases, there is no fraudulent intent but more an unrealistic expectation that the company will continue to trade and be able to pay its obligations.

14) A common situation is where the company then faces legal pressure from creditors and also finds it harder to obtain credit, so the directors simply jettison it and commence in a fresh company, where the pattern tends to be repeated. This process can be carried out because it is extremely difficult for creditors to take successful legal action to get their hands on the assets of the directors.

15) This is a far greater problem for SMEs than illegal, criminal, fraudulent phoenixing activity.

WHAT CAN SMEs DO?

16) The standard advice for potential creditors of small companies is to do credit checks, talk to trade references, do a company search to see if there has been any wind-up activity and also ask for personal guarantees from the directors.

17) Nothing in the proposed anti-phoenixing proposals would alter the advice to creditors to carry out such checks and obtain guarantees.

18) The proposals we set out below are more far-reaching but would significantly reduce the risks creditors take in advancing credit to small companies and would act as a brake on operators who have a pattern of setting up companies which ultimately fail.

REGISTER OF STATUTORY DEMANDS

19) Under the Corporations Law (Section 459E), it is possible to serve a Statutory Demand on a company where the debt owed exceeds $2,000.00 and where it is not subject to dispute. No judgment is required.

20) Mendelsons use the Statutory Demand process on a regular basis and obtain good results from it.

21) The benefits are that there are no external disbursements payable and it is quick and cheap.

22) The way the process works is that the Statutory Demand is served on the company by post at its registered address and it details the amount demanded. The debtor-company has 21 days in which to "satisfy the Demand" or otherwise, to take action in the court to seek an order that there is a genuine dispute about the account or that otherwise, the company is solvent.

23) In our experience, it is rare for a company to respond to the Statutory Demand by seeking a court order and the greatest response is usually to pay or settle the amount demanded.

24) If the Statutory Demand is not satisfied and no action is taken by the debtor-company, then from that time onward, the debtor-company is deemed to be insolvent and if it continues trading, the directors are personally exposed to insolvent trading action in relation to any losses suffered by creditors after that date. From that time, the creditor may then use the failure to satisfy the Statutory Demand as a ground for commencing wind-up action of the company.

25) The problem is that many companies simply do not respond to a Statutory Demand and continue trading, in the knowledge that the creditor is unlikely to incur the cost of wind-up action (approximately $5,000.00), on the basis that it is unlikely to provide a financial return.

STATUTORY DEMAND REGISTER ('REGISTER')

26) Our first proposal is that a register be set up by ASIC of companies which have been subject to a Statutory Demand which has not been satisfied, where the debtor company has not initiated legal action in relation to the Statutory Demand and where the creditor has a reasonable belief that the amount demanded is still owed.

27) This is not the place to go into the proposed detailed workings of the Register but we believe that it could be set up simply, through an online process and it could be easily searched, without charge by businesses which plan to allow credit to the company. There could be a simple objection process, to ensure that the system is not abused.

28) If the Register is in place, it would be the first time there would be visibility by both the public and the regulators to Statutory Demands which are being served and which are not satisfied.

29) If this in place, recalcitrant companies which have not satisfied Statutory Demands would find it difficult to obtain credit.

SOLVENCY STATEMENTS

30) Our second proposal is that directors of a company should be obliged to sign a "Solvency Statement", if requested to by a business which intends providing credit of over a fixed sum of say $5,000.00 to that company.

31) The Solvency Statement would be signed by all directors and would state that, as at the time of the Statement, the directors are of the reasonable belief that the company is solvent (defined as being able to pay its debts as and when they fall due).

32) If the company ultimately fails to pay a genuine debt for over $5,000.00 and the creditor has received the Solvency Statement, the creditor would then be entitled to sue the directors for the amount of the debt and the sole defence of the directors would be that as at the time of the statement, the company was solvent but that a later event occurred which rendered the company unable to pay its just debts.

COMBINING STATUTORY DEMAND REGISTER WITH SOLVENCY STATEMENTS

33) An extension of the ideas expressed above would be to provide that any company which appears on the Statutory Demand Register should also be required to complete a Solvency Statement within a 14 day period, in order that it be allowed to continue trading. If it fails to provide the Solvency Statement then ASIC should have the ability to investigate the company to determine whether or not it is engaging in any of the "designated phoenixing activities" (as proposed) or to otherwise appoint an external administrator.

34) Failure to lodge a Solvency Statement in the circumstances described in paragraph 33 could also lead to deregistration of the company by ASIC.

IMPROVEMENT IN DEREGISTRATION OUTCOMES

35) Deregistration of a company can be made either by ASIC (usually for failure to lodge annual returns and pay fees) or by the directors themselves.

36) Voluntary deregistration is initiated by the directors and it involves them in signing a Statutory Declaration declaring, inter alia, that the company has no creditors when submitting the request to ASIC for it to be deregistered.

37) We come across numerous circumstances where we know that the declaration made by the directors is false, usually because we are actually dealing with the company at that time in relation to an outstanding debt.

38) In our experience, ASIC does nothing about these false declarations, which leaves creditors with no further action to take.

39) Our suggestion is that ASIC encourage creditors to lodge a complaint when a company has been deregistered by the directors and there is clearly at least one debt outstanding. The action taken should be to prosecute the directors for perjury, in that the claim would be that they have knowingly sworn a declaration which they must have known to be false.

40) Following that process would significantly reduce the number of voluntary deregistrations, which is basically regarded by shady directors as an easy and cheap way to "get rid of the company". Liquidation is expensive and a liquidator is bound to investigate past transactions which potentially would give rise to claims made against directors and shareholders.

DEREGISTRATION BY ASIC

41) A large number of companies are deregistered by ASIC each year, usually due to the failure to lodge annual returns or to pay annual fees.

42) Upon deregistration of a company, all of its assets are supposed to vest with ASIC. However, this is, to our knowledge, never undertaken. Assets include loans made by the company to associated parties, including directors and shareholders and technically these "assets" should pass to ASIC and should then be enforced as debts owing to the company, but they never are.

43) If a creditor believes that there may be assets which have simply been "spirited" away from the deregistered company, the only option is to make application to the court to reinstate the company, naming ASIC as a party and then appointing a liquidator of the company, in order that he may then review all concerning transactions undertaken by the company and undertake recovery. This is rarely done because of the high cost and risk.

44) The current process for deregistration by ASIC is simply aiding both fraudulent phoenix operators and otherwise dodgy company directors and basically acts as a barrier against recovery of debts by SMEs.

IMPROVED ACCESS TO COMPANY INFORMATION

45) We recommend that ASIC adopt the New Zealand process, whereby it is simple and cheap and immediate to search company information and to come to a relatively informed decision about the credit worthiness of the company, before advancing credit.

46) The link to this is www.companiesoffice.govt.nz

SUMMARY

47) We believe that implementation of our suggestions would very significantly reduce the risk creditors' face in providing credit to small companies and would also act as a real deterrent to entrepreneurs setting up businesses which ultimately have a low rate of success.

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Date: 11th October 2017
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Submission to the Minister for Revenue and Financial Services in relation the Transparency of Tax Debt measure.

DETAILS OF PARTIES MAKING THE SUBMISSION

1) This submission is made on behalf of Mendelsons National Debt Collection Lawyers Pty Ltd ACN 125 099 701 ('Mendelsons') and Prushka Fast Debt Recovery Pty Ltd ACN 005 962 854 ('Prushka').

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BACKGROUND

5) The Minister for Revenue and Financial Services has released draft legislation and an explanatory memorandum that outlines the plan to allow the Australian Taxation Office ('ATO') to disclose information to credit reporting bureaus relating to overdue tax debts.

6) The criteria is that the tax payer entity has:

- An Australian Business Number and is not an excluded entity; and
- A tax debt of which at least $10,000 is overdue by more than 90 days; and
- Not effectively engaged with the ATO to manage its tax debt.

7) A protection inserted is that the Inspector-General of Taxation ('IGT') must take overall responsibility, prior to disclosure, to ensure that tax payers are not unfairly impacted by information which should not have been disclosed. This consultation is to establish if an entity has made a complaint to the IGT about the ATO's notice of intention to report the entity's tax debt information.

8) Entities that are not considered to carry on a business as their main purpose are excluded from the draft legislation. These are:

- Deductible gift recipients;
- Not for profit entities;
- Government entities;
- Complying superannuation entities.

9) The stated reasons for the draft legislation are to:

- Support businesses to make more informed decisions by making overdue debts more visible;
- Reduce the unfair advantage obtained by entities that do not pay their tax on time;
- Encourage entities to engage with the ATO to manage their tax debts.

10) It has also been reported that "at its core, the legislation intends to target phoenix operators and businesses which are at risk of ceasing production".[1]

WILL THE MEASURE HELP THE SME SECTOR?

11) We do not believe that the measure will assist SMEs for the reasons set out below.

12) Most SMEs do not operate a sophisticated credit checking process, so they will simply be unaware of the information and will not have the processes in place to obtain credit reporting.

13) Conversely, the parties which will benefit from this will be larger businesses, which operate a credit department and have processes in place to carry out credit checks.

14) Ironically, this may then well act against the best interest of those SMEs which are subject of adverse reports because then it is likely to make it much more difficult for them to obtain credit and may also result in credit facilities being withdrawn.

15) The measure is specifically intended to reduce the incentive for a tax payer to prioritise the payment of their non-tax debts over their tax debts. Any funds that a business may otherwise have available to it to pay other creditors will therefore go to the ATO first and indeed, may be diverted to the ATO by businesses simply to ensure that they do not meet the criteria for disclosure by the ATO to any credit reporting bureau. The measure will therefore potentially put pressure onto SME's not only as a tax payer but also as a creditor.

16) The Commissioner will have the discretion about what to disclose to a credit reporting bureau and when, even when the relevant criteria is met by a tax payer.

17) In addition, it is acknowledged that only information about debts known to the Commissioner can be disclosed – an entity that has an outstanding lodgment obligations may have debts owed to the Commissioner which are unknown.

[1] See https://www.accountantsdaily.com.au/tax-compliance/11223-new-law-proposed-to-increase-tax-debt-exposure?utm_source=Accountants%20Daily&utm_campaign=12_01_18&utm_medium=email&utm_content=2

18) The ATO is also expected to update the credit information and this will continue until the entity no longer meets the reporting criteria, in which case it will be removed.

19) It will therefore be difficult for an SME to rely on credit information obtained at any given time as it may not reflect a reliable and overall financial position from which the SME will be able to draw accurate inferences. This will require the SME to undertake regular credit checks on a customer, which, as noted from the outset, will not be available or feasible for many SMEs.

20) Knowing that a business does not pay its bills on a consistent basis is important. In targeting only one type of debt (i.e. tax debts), the utility of the measure is therefore limited. Owing a debt to the ATO does not mean that the tax payer is necessarily insolvent, a phoenix entity or otherwise not credit-worthy.

21) We are seeing debts owed to SMEs by charitable organisations and superannuation entities. Under the draft legislation, these entities will be excluded from the measure. To align with all purposes of the measure, we are of the view that no entities should be excluded. Whilst the main purpose of these entities may not be considered in the carrying on of a business, they do nevertheless request the provision of goods and/or services from time to time.

BENEFIT FOR THE ATO

22) The amendments may result in the ATO receiving payments from tax payers in priority to other creditors.

23) Notwithstanding the stated intention of the change, there is a real risk that, over time, the process may be used by certain officers within the ATO to lever tax payers into making payment on the basis of "if you don't pay this debt, we will notify the credit reporting agencies and this will make it very difficult for you to obtain credit".

24) Although there will be 'rigorous administrative arrangements' and other protective measures in place, it is unknown as to how the measure will exactly be administered. Any bureaucratic process involving significant numbers has a risk of non-compliance over a period of time.

WHAT SHOULD SMEs DO?

25) Any SME which proposes advancing credit should carry out proper credit checks on their customer and by using different avenues.

26) This would involve obtaining a completed Credit Application Form and, if the amount of credit is large (in terms of the business), independent referees should be checked and also the customer's accountant (subject to the customer's authority) should be contacted and be asked the question: "Do you know of any reason why company XYZ should not be granted credit of 'X'?".

27) We recommend that for any significant amounts of credit, personal guarantees be obtained from all directors of the customer company. This will substantially reduce the risk of loss because even if the company becomes insolvent, the chances of recovery against the directors will be much higher.

28) SMEs should set credit limits and ensure that their business is strictly adhering to same. There should also be a process to review the credit limits on a regular basis and considered in accordance with whether the customer has been paying on time or is consistently in default.

SUMMARY

29) We acknowledge and welcome the draft legislation to the extent that it may assist businesses (and in particular, SMEs) to make more informed decisions. However, we feel overall, that the measure largely benefits the ATO in ensuring that payments are made to it and that it will not benefit SMEs to the extent that has been stated nor assist greatly to target the issue of phoenix operators.

Date: 5 February 2018.

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National Debt Collection Lawyers

PRUSHKA
FAST DEBT RECOVERY
NO RECOVERY - NO CHARGE

Submission to Proposed Reforms to Combat Illegal Phoenix Activity

DETAILS OF PARTIES MAKING THE SUBMISSION

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ILLEGAL PHOENIXING

5) The act of registering a new company to take over a failed or insolvent business of a predecessor is not in and of itself is not illegal. In some instances, is a legitimate form of business rescue.

6) It becomes fraudulent when it is carried out to intentionally avoid paying creditors by stripping the old company of assets to avoid paying liabilities and leaving it insolvent.

PROPOSALS

Creditor-Defeating Dispositions

7) Schedule 1 introduces new offences to prohibit creditor-defeating dispositions of company property, penalise those who engage in or facilitate such activity and extends the existing asset clawback provisions to allow liquidators and ASIC to recover any such property.

8) A creditor-defeating disposition is one that has the effect of preventing, hindering or significantly delaying the property becoming available to meet the demands of the company's creditors in the event of a winding-up.

9) A transaction may be voidable if it is a creditor-defeating disposition and is made when the company is insolvent, or, because of the disposition, the company immediately becomes insolvent or enters external administration within the following 12 months.

10) The amendments provide that:

    (a) Liquidators can seek the recovery of assets or other consideration through the Courts for the benefit of the company's creditors;

    (b) ASIC can make orders to recover assets for the company's creditors;

    (c) Liquidators (and in some instances, creditors) can recover compensation from a company's officers and other persons responsible for a company making a creditor-defeating disposition;

    (d) It is a criminal offence for officers to engage in conduct that results in a company making a prohibited creditor-defeating disposition. Civil penalties also apply;

    (e) It is a criminal offence for a person to procure, incite, induce or encourage a company to make a prohibited creditor-defeating position. Civil penalties also apply;

    (f) The safe harbour provisions are also available to officers and/or other persons as a defence against alleged contravention of the creditor-defeating disposition prohibitions.

11) We support the prohibition and introduction of a new creditor-defeating deposition as the sections appear to operate in a similar way to the already existing and comparative provisions in the *Bankruptcy Act 1966* and brings consistency between the corporate and individual insolvency regimes in this regard. It is another way in which the corporate veil is being pierced to hold individual directors accountable in circumstances where the corporate structure should not protect them from such behavior.

12) Whilst a lot of investigation may still be required by a liquidator to establish the existence of a creditor-defeating disposition, with the targeted activity now being explicitly stated as being an offence will hopefully significantly reduce the cost of actions being taken to recover the property and/or to seek compensation for loss suffered arising from same.

13) The amendments are intended to ensure that ASIC has the power to take effective action against illegal phoenix activity and protect the interests of legitimate creditors. This is a positive step in acknowledging and assisting to alleviate the difficulties faced by liquidators where the company has insufficient funds to cover the cost of any Court action. Whether ASIC will have the resources to actually take effective action is a separate issue.

14) Targeting pre-insolvency advisers and the like is welcomed. Not all are unscrupulous and intentionally provide tax avoidance and/or creditor-defeating disposition advice. However, we feel that the introduction of these reforms will help to ensure the quality of any advice given in this space and limit those that are currently taking advantage of the system.

15) Having been introduced into law only recently, the safe harbour provisions are still yet to be subject to any judicial determinations. How the safe harbour provisions are being used and/or attacked in the context of insolvent trading claims against directors is yet to be seen and we now follow with interest how and if they will translate to achieve a balance between legitimate business rescue and illegal phoenix activity.

Accountability of Directors

16) Schedule 2 ensures that directors are held accountable for misconduct by preventing directors from improperly backdating resignations or ceasing to be a director when this would leave the company with no directors.

17) Accurate timelines of when directors and officeholders are appointed or resign is important. Equally as important is directors complying with their obligations to ensure that registered offices and their own contact addresses, as they appear on company searches, are up to date.

18) In our practice, we have come across company searches that clearly contain a notation that ASIC has received return mail from the company's registered office and/or the director's residential address. Yet, there are no adverse dealings or action against the company that can immediately be seen from public records and for all intents and purposes, the company remains registered to continue to trade and/or to incur debts whether engaging in illegal phoenixing activity or not. In these instances, ASIC has been put on notice that the status of the company should be investigated further and it has not seemingly commenced any such inquiries of its own motion. ASIC will need to be the ones to hold directors accountable as the legislation alone will not do it.

19) For creditors, simply having a name without current contact details for the director can be the difference between the recovery of a debt and in the more severe of circumstances, financial distress if unrecovered.

20) Ensuring that a company is not left without a director is not enough if the details of the remaining director and/or newly appointed director are not somehow verified.

21) The introduction of the Director Identification Numbers (**DIN**) will assist to some extent in this regard, but it can only go so far if:

    (a) Directors are not required to provide proof of identity by way of 100 points of identification to verify their details;

    (b) Aliases, Anglicised names and spelling variations are not investigated or identified;

    (c) Individuals qualify as being appointed as directors by being ordinarily resident in Australia but who go overseas for extended and lengthy periods of time are not flagged, as the effect of this upon creditors is akin to leaving the company without a director;

    (d) Appropriate considerations and measures are not given to shadow directors who may intentionally avoid the DIN "tracking" system.

22) Part 2D.6 of the *Corporations Act 2001* already provides a statutory regime to identify and disqualify high risk individuals from managing corporations. Section 206D, in particular, targets the disqualification of persons from managing companies if, amongst other things, the failure of the company is linked to insolvency and the non-payment of debts.

23) The extent to which directors have been disqualified under Part 2D.6 is, to our knowledge, limited. We hope that the increased and targeted focus on illegal phoenixing activity together with the introduction of Director Identification Numbers will change this.

24) We welcome these reforms, although query the extent to which the information submitted by directors will be scrutinised and whether action will indeed be taken in practice. Again, the resourcing of ASIC to monitor this is crucial.

Tax Liabilities

25) Schedule 3 allows the Commissioner to collect estimates of anticipated GST liabilities and make company directors personally liable for their company's GST liability in certain circumstances.

26) Schedule 4 authorises the Commissioner to retain tax refunds where a taxpayer has failed to lodge a return or provide other information that may affect the amount the Commissioner refunds. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund.

Related Creditors

27) Through proposed amendments to the *Insolvency Practice Rules (Corporations) 2016* the reforms prevent related creditors from facilitating phoenix activity by unduly influencing the removal or replacement of external administrators. The aim is to reduce the incidence of illegal phoenixing activity, its effect on creditors and to help ensure the independence of external administrators.

28) The manner in which the amendments seeks to achieve the above is to limit related creditors' voting rights to the value of the consideration they paid for an assigned debt when conducting a poll for a resolution concerning the appointment or removal of an external administrator. External administrators will now be required to ask creditors (whether related creditors or not) to provide evidence in writing in relation to any assigned debt and the consideration provided for the assignment.

29) We support the proposed reforms. It will be imperative, however, for liquidators to have the resources to confirm, identify and verify the information provided to it as not all related parties or creditors placed to influence votes are always immediately clear without further scrutiny and cross-referencing of information.

GENERAL

30) The proposed reforms create penalties and monetary outcomes that can be imposed upon and recovered from directors personally.

31) It will be interesting to see how this interacts with the anticipated introduction of the 1 year bankruptcy and whether this will minimise the intended impact on personal liability.

SUMMARY

32) In our October 2017 submissions addressing the draft proposals on illegal phoenixing activity released for consultation at that time, we suggested that there already exists a variety of laws and measures dealing with acts that may constitute such activity. What has been lacking is the allocation of resources to counter such activity. Whilst we welcome the proposed reforms that creates additional offences and increased penalties, our position on this point remains the same.

33) The proposed reforms provide ASIC with more powers. This means that ASIC will need to find the time and personnel to ensure that it utilises those powers effectively and efficiently. It will also concurrently need to monitor companies and address any public complaints made

either directly to it or through the 'whistleblower hotline'. Unfortunately, our experience and observations of ASIC to date, is that it has lacked the ability to be "the enforcer" over incorporated entities of many of its already existing rights and responsibilities. ASIC will need to demonstrate that it has the capacity to undertake what it needs to, in order for a large number of these reforms to work as intended.

34) In more recent years, ASIC has seemingly initiated more actions against directors in furtherance of its commitment to tackling illegal phoenixing activities. We hope that this is not as a result of the current hype around combatting illegal phoenixing activity and is maintained.

35) We experience phoenixing on a daily basis. Most of it is not intentional but is as a result of poor business decisions and often directors operating business which have little hope of success. From the point of view of creditors, the result is the same.

36) We set out again our proposals for a Statutory Demand Register, Solvency Statements and the Deregistration process implementing those ideas would be simple, cheap and largely wipe out incidental phoenixing actively.

REGISTER OF STATUTORY DEMANDS

37) Under the Corporations Law (Section 459E), it is possible to serve a Statutory Demand on a company where the debt owed exceeds $2,000.00 and where it is not subject to dispute. No judgment is required.

38) Mendelsons use the Statutory Demand process on a regular basis and obtain good results from it.

39) The benefits are that there are no external disbursements payable and it is quick and cheap.

40) The way the process works is that the Statutory Demand is served on the company by post at its registered address and it details the amount demanded. The debtor-company has 21 days in which to "satisfy the Demand" or otherwise, to take action in the court to seek an order that there is a genuine dispute about the account or that otherwise, the company is solvent.

41) In our experience, it is rare for a company to respond to the Statutory Demand by seeking a court order and the greatest response is usually to pay or settle the amount demanded.

42) If the Statutory Demand is not satisfied and no action is taken by the debtor-company, then from that time onward, the debtor-company is deemed to be insolvent and if it continues trading, the directors are personally exposed to insolvent trading action in relation to any losses suffered by creditors after that date. From that time, the creditor may then use the failure to satisfy the Statutory Demand as a ground for commencing wind-up action of the company.

43) The problem is that many companies simply do not respond to a Statutory Demand and continue trading, in the knowledge that the creditor is unlikely to incur the cost of wind-up action (approximately $5,000.00), on the basis that it is unlikely to provide a financial return.

STATUTORY DEMAND REGISTER ('REGISTER')

44) Our first proposal is that a register be set up by ASIC of companies which have been subject to a Statutory Demand which has not been satisfied, where the debtor company has not initiated legal action in relation to the Statutory Demand and where the creditor has a reasonable belief that the amount demanded is still owed.

45) This is not the place to go into the proposed detailed workings of the Register but we believe that it could be set up simply, through an online process and it could be easily searched, without charge by businesses which plan to allow credit to the company. There could be a simple objection process, to ensure that the system is not abused.

46) If the Register is in place, it would be the first time there would be visibility by both the public and the regulators to Statutory Demands which are being served and which are not satisfied.

47) If this in place, recalcitrant companies which have not satisfied Statutory Demands would find it difficult to obtain credit.

SOLVENCY STATEMENTS

48) Our second proposal is that directors of a company should be obliged to sign a "Solvency Statement", if requested to by a business which intends providing credit of over a fixed sum of say $5,000.00 to that company.

49) The Solvency Statement would be signed by all directors and would state that, as at the time of the Statement, the directors are of the reasonable belief that the company is solvent (defined as being able to pay its debts as and when they fall due).

50) If the company ultimately fails to pay a genuine debt for over $5,000.00 and the creditor has received the Solvency Statement, the creditor would then be entitled to sue the directors for the amount of the debt and the sole defence of the directors would be that as at the time of the statement, the company was solvent but that a later event occurred which rendered the company unable to pay its just debts.

COMBINING STATUTORY DEMAND REGISTER WITH SOLVENCY STATEMENTS

51) An extension of the ideas expressed above would be to provide that any company which appears on the Statutory Demand Register should also be required to complete a Solvency Statement within a 14 day period, in order that it be allowed to continue trading. If it fails to provide the Solvency Statement then ASIC should have the ability to investigate the company to determine whether or not it is engaging in any of the "designated phoenixing activities" (as proposed) or to otherwise appoint an external administrator.

52) Failure to lodge a Solvency Statement in the circumstances described in paragraph 33 could also lead to deregistration of the company by ASIC.

IMPROVEMENT IN DEREGISTRATION OUTCOMES

53) Deregistration of a company can be made either by ASIC (usually for failure to lodge annual returns and pay fees) or by the directors themselves.

54) Voluntary deregistration is initiated by the directors and it involves them in signing a Statutory Declaration declaring, inter alia, that the company has no creditors when submitting the request to ASIC for it to be deregistered.

55) We come across numerous circumstances where we know that the declaration made by the directors is false, usually because we are actually dealing with the company at that time in relation to an outstanding debt.

56) In our experience, ASIC does nothing about these false declarations, which leaves creditors with no further action to take.

57) Our suggestion is that ASIC encourage creditors to lodge a complaint when a company has been deregistered by the directors and there is clearly at least one debt outstanding. The action taken should be to prosecute the directors for perjury, in that the claim would be that they have knowingly sworn a declaration which they must have known to be false.

58) Following that process would significantly reduce the number of voluntary deregistrations, which is basically regarded by shady directors as an easy and cheap way to "get rid of the company". Liquidation is expensive and a liquidator is bound to investigate past transactions which potentially would give rise to claims made against directors and shareholders.

DEREGISTRATION BY ASIC

59) A large number of companies are deregistered by ASIC each year, usually due to the failure to lodge annual returns or to pay annual fees.

60) Upon deregistration of a company, all of its assets are supposed to vest with ASIC. However, this is, to our knowledge, never undertaken. Assets include loans made by the company to associated parties, including directors and shareholders and technically these "assets" should pass to ASIC and should then be enforced as debts owing to the company, but they never are.

61) If a creditor believes that there may be assets which have simply been "spirited" away from the deregistered company, the only option is to make application to the court to reinstate the company, naming ASIC as a party and then appointing a liquidator of the company, in order that he may then review all concerning transactions undertaken by the company and undertake recovery. This is rarely done because of the high cost and risk.

62) The current process for deregistration by ASIC is simply aiding both fraudulent phoenix operators and otherwise dodgy company directors and basically acts as a barrier against recovery of debts by SMEs.

Date: 27th September 2018

Contact

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Submission to Modernising Business Registers and Director Identification Numbers Legislation

DETAILS OF PARTIES MAKING THE SUBMISSION

1) This submission is made on behalf of Mendelsons National Debt Collection Lawyers Pty Ltd ACN 125 099 701 (**Mendelsons**) and Prushka Fast Debt Recovery Pty Ltd ACN 005 962 854 (**Prushka**).

2) Mendelsons is the in house law firm of Prushka and it focusses on debt recovery and insolvency in all Australian jurisdictions, specialising in commercial debt collection.

3) Prushka has a 42 year history and handles debt collection work for over 56,000 businesses across Australia, mostly being SMEs but also for larger corporate clients. Prushka acts on the No Recovery – No Charge basis and has a strong presence across regional Australia.

4) This submission is written by Roger Mendelson, Principal Lawyer of Mendelsons and CEO of Prushka and Alison Lee, Special Counsel and Practice Manager of Mendelsons.

PROPOSALS

Modernisation of Commonwealth Registers

5) The legislative package creates the *Commonwealth Registers Act 2018* (**New Act**) with the stated objective to facilitate a modern government registry regime that is flexible and both technology and government neutral (**Stated Objective**).

6) It is only 'registry' aspects of the current law that are being brought into the new registry regime. 'Regulatory' functions and powers are not going to be affected by the new law and continue to be administered by the body that currently administers those functions and powers. Therefore, how the relevant regulators interacts with the entities it regulates or how information flows between them is not encompassed in this new law.

7) Information related to 34 registers currently being kept by ASIC and the Australian Business Register which is currently kept by the Commissioner of Taxation will initially be subject to the new registry regime. These registers are set out in Table 1.1 of the Exposure Draft Explanatory Materials. Additional registers may be brought into the regime by future legislative reforms.

8) Under the new regime, the Minister may, by notifiable instrument, appoint any existing Commonwealth body (as defined in the New Act) to be the registrar. State government bodies or a private body cannot be appointed as registrar. Any appointed body may also be changed by the Minister at any time.

9) The new law sets out the functions and powers of the registrar, with most of these already set out in existing Commonwealth laws and more specifically, in the existing provisions of primary and subordinate legislation that relate to the registers being brought into the regime, as well as laws of general application such as those relating to freedom of information, archiving of Commonwealth records, good governance and management of financial resources.

10) The consequential amendments therefore do not create new functions and powers. They transfer existing functions and powers, which are currently allocated to specific regulators, to the registrar.

11) The Minister may prescribe additional functions for the registrar by rules made for this purpose as required, permitted, necessary or convenient to be prescribed for the carrying out or giving effect to the new Act.

12) The functions and powers apply to all information subject to new regime, therefore designed to enable a more holistic, consistent and flexible application of the regime regardless of the information that it holds.

13) In respect of the amended functions and powers of the registrar, these relate to:

- The subject matters for which the registrar can collect information.
- How persons make applications to the registrar for certain things.
- The ability of the registrar to assess those applications.
- The ability of the registrar to hold information.

14) The registrar performs its functions and powers in accordance with the data standards that the new law allows the registrar to make and other Commonwealth laws. Data standards are disallowable instruments for the purposes of the *Legislation Act 2003* and therefore will be subject to the same parliamentary scrutiny and process to disallow currently applicable to regulations.

15) The data standards relate to the performance of the registrar's function and the exercise of the registrar's powers and may deal with a variety of registry related matters dealt with in existing legislation that does not currently meet the Stated Objective.

16) The benefits of the functions and powers being contained in the New Act overcome the following difficulties with the current regime that creates regulatory burden and an increase in the cost of administering registry services:

- Registers being maintained separately from each other despite sometimes containing similar information leading to the same information needing to be provided several times in relation to different registers.
- Regulators having limited abilities to determine what information is required for each register leading to outdated registers.
- Regulators having varying abilities to determine the manner and form in which registry information is collected resulting in inefficiencies, inability to make full use of technology and to consistently and flexibly deal with incomplete/defective applications.

- Different and/or inconsistent rules applying to the management and use of registers resulting in Government failing to make best use of registry data.

17) The new law provides for the recording, protection and disclosure of information held by the registrar, including disclosure via a disclosure framework made by the registrar. Under the disclosure framework, the registrar may authorise the disclosure of registry information where it is satisfied that the benefits of the disclosure outweigh the risks, after those risks have been mitigated. The new law also clarifies that the disclosure framework may include different provisions relating to the different functions or powers of the registrar, which ensures that the disclosure framework can be tailored to particular functions and powers of the registrar.

18) The disclosure framework is also a disallowable instrument for the purposes of the *Legislation Act 2003*. In addition, the framework will be subject to consultation requirements under that legislation together with privacy impact assessments under the *Privacy Act 1988*.

19) The new law otherwise provides for other matters intended to support the effectiveness and efficiency of the regime, including:

- When the Minister can direct the registrar;
- The circumstances in which, and to whom, the registrar may delegate its functions and powers;
- The use of assisted decision making processes by the registrar;
- Review rights with respect to decisions made by the registrar;
- The extent to which the registrar and associated persons may be liable for damages in connection with the new regime, including statutory immunity for acts done in good faith and when such immunity applies;
- The admissibility of registry information in court proceedings to enable a document, or a copy of a document, that purports to be an extract of information held by the registrar, to be admissible as prima facie evidence of the information stated in it without the need for certification or any other further proof of, or the production of, the original;
- The information that must be included in the registrar's annual report about the operation of the new regime;
- What rules may be made by the Minister for the purposes of the new regime.

20) The intention is to ensure a coordinated approach across several governmental bodies across which the functions and powers are currently allocated.

21) We support the New Act and its Stated Objective.

22) Currently, it is our expectation (from experience) that ABR is not always accurate and up to date and that information extracted from the records maintained by ASIC is more reliable. The new regime will boost the public confidence in the accuracy and reliability of the information obtained, understanding that the information will be, amongst other things, gathered, maintained and updated by the registrar and sourced from the one registry.

23) The flexibility of the regime aligns with the Stated Objective of the New Act and is seemingly required to achieve its application in an efficient and effective manner. Whilst only time will tell, we hope that any flexibility that replaces any prescriptive parts of the regime does not impact negatively and produce unintended consequences such that the consistency and accuracy of the information is inadvertently not maintained instead as a result.

24) The centralisation of information will also hopefully assist the relevant regulators to enforce the law as currently, we see some need for improvement, particularly from ASIC in this regard. It is not only about streamlining processes and obtaining information easily and efficiently but also using that information to produce outcomes.

Future Registers

25) As noted earlier, additional registers may be brought into the regime by future legislative reforms.

26) We again take the opportunity to set out our proposals outlined in previous submissions for a Statutory Demand Register as implementing the idea would be simple, cheap and largely wipe out incidental phoenixing actively.

Statutory Demands

27) Under the Corporations Law (Section 459E), it is possible to serve a Statutory Demand on a company where the debt owed exceeds $2,000.00 and where it is not subject to dispute. No judgment is required.

28) Mendelsons use the Statutory Demand process on a regular basis and obtain good results from it.

29) The benefits are that there are no external disbursements payable and it is quick and cheap.

30) The way the process works is that the Statutory Demand is served on the company by post at its registered address and it details the amount demanded. The debtor-company has 21 days in which to "satisfy the Demand" or otherwise, to take action in the court to seek an order that there is a genuine dispute about the account or that otherwise, the company is solvent.

31) In our experience, it is rare for a company to respond to the Statutory Demand by seeking a court order and the greatest response is usually to pay or settle the amount demanded.

32) If the Statutory Demand is not satisfied and no action is taken by the debtor-company, then from that time onward, the debtor-company is deemed to be insolvent and if it continues trading, the directors are personally exposed to insolvent trading action in relation to any losses suffered by creditors after that date. From that time, the creditor may then use the failure to satisfy the Statutory Demand as a ground for commencing wind-up action of the company.

33) The problem is that many companies simply do not respond to a Statutory Demand and continue trading, in the knowledge that the creditor is unlikely to incur the cost of wind-up action (approximately $5,000.00), on the basis that it is unlikely to provide a financial return.

Statutory Demand Register

34) Our proposal is that a register be set up of companies which have been subject to a Statutory Demand which has not been satisfied, where the debtor company has not initiated legal action in relation to the Statutory Demand and where the creditor has a reasonable belief that the amount demanded is still owed (**Register**).

35) This is not the place to go into the proposed detailed workings of the Register but we believe that it could be set up simply, through an online process and it could be easily searched, without charge by businesses which plan to allow credit to the company. There could be a simple objection process, to ensure that the system is not abused.

36) If the Register is in place, it would be the first time there would be visibility by both the public and the regulators to Statutory Demands which are being served and which are not satisfied.

37) If this in place, recalcitrant companies which have not satisfied Statutory Demands would find it difficult to obtain credit.

Director Identification Numbers

38) The act of registering a new company to take over a failed or insolvent business of a predecessor is not in and of itself is not illegal. In some instances, it is a legitimate form of business rescue.

39) It becomes fraudulent when it is carried out to intentionally avoid paying creditors by stripping the old company of assets to avoid paying liabilities and leaving it insolvent. This is known as illegal phoenixing activity and is done by the controllers, or directors, of the company.

40) Schedule 2 of the *Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2018* amends the *Corporations Act 2001* (CW) (**CA**) and the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (**CATSI**) to introduce a Director Identification Number (**DIN**).

41) The objective of the new requirement is to promote good corporate conduct and assist regulators to detect and address unlawful behavior and by doing so, to deter such behavior.

42) The DIN will require all directors to confirm their identity and it will be a unique identifier for each person who consents to being a director which will be kept, even if that person's directorship with a particular company ceases. The DIN will not, initially, extend to de facto or shadow directors. However, the new law provides that "eligible officers" are subject to the new requirement and defines this term. The definition may be extended by regulation to any other officers of a registered body with the effect that the DIN may apply to any such officer if doing so is appropriate. The intention is to provide the flexibility necessary to ensure the effectiveness of the new requirement into the future.

43) The current law requires directors to lodge their details with ASIC, but does not require ASIC to verify the identity of directors. The verification via DIN will prove the integrity of the data and help enforcement associated with phoenixing.

44) Under the new requirement, a person appointed as a director of a company must apply to the registrar for a DIN within 28 days from the date they are appointed a director unless they are provided an exception or extension by the registrar. After receiving an application,

the registrar must provide the director with a DIN if the registrar is satisfied that the director's identity has been established. Persons that are currently appointed as a director has 15 months to apply for a DIN from the application day of the new requirement. It is also a defence in relation to this obligation if the director was appointed without the knowledge, with the evidential burden resting on the person seeking to rely on the defence.

45) The registrar is provided with powers to administer the new requirement. These include powers to issue DINs, keep necessary records, cancel and re-issue DINs, determine the numbering of DINs and determine how directors are to establish their identity. The registrar may make data standards, by way of legislative instrument, in relation to these and other matters.

46) Civil and criminal penalties exist for directors that fail to apply for a DIN within the applicable timeframe and to conduct that otherwise undermines the new DIN requirement. For example, providing false identification documents to the registrar, providing a false DIN and intentionally apply for multiple DINs. For this purpose, the new law relies upon existing prohibitions in the *Criminal Code*, the CA and CATSI that aim to prevent the provision of false or misleading information.

47) The registrar will administer the registry aspects of the DIN whilst the regulators that have the general administration of the CA and CATSI will enforce the provisions.

48) We support the idea of DINs because it will certainly make it easier to track directors and will act as a means of deterrent for directors who are serially operating companies which will ultimately fail. The impact will be similar to the introduction of the ACN, which made it much easier to track companies.

49) The DIN will also assist creditors when undertaking credit checks and/or in the recovery of any bad debts as well as external administrators appointed to companies to investigate the corporate history of directors, improving the insolvency process.

50) The integrity of the DIN will, however, come down to the effectiveness of the registrar in verifying the director's identity and cross-referencing not only information provided by the director, but also information that may already be available to the registrar.

51) It is also important that bodies tasked with the issuing of various identification documents also undertake the necessary checks at first instance. We are aware of many instances in which a person's date of birth and/or spelling of name(s) does not match across all of their identity documents. If applicable, all of this mismatching data should be collated and marked as being associated with the same person in order to appropriately identify information as indeed belonging to the one person and to properly avoid the application for and the obtaining of multiple DINs.

52) As stated in our previous response to submissions on the draft legislation introduced on this point/area and re-stated again below, the introduction of the DINs will assist to some extent in addressing the problems it intends to, but it can only go so far if:

    (a) Directors are not required to provide proof of identity by way of 100 points of identification to verify their details and this verification process is thorough and comprehensive (noting the identification process is yet to be confirmed);

    (b) Aliases, Anglicised names and spelling variations are not investigated or identified;

(c) Individuals qualify as being appointed as directors by being ordinarily resident in Australia but who go overseas for extended and lengthy periods of time are not flagged, as the effect of this upon creditors is akin to leaving the company without a director;

(d) Appropriate considerations and measures are not given to shadow directors who may intentionally avoid the DIN "tracking" system.

53) Part 2D.6 of the *Corporations Act 2001* already provides a statutory regime to identify and disqualify high risk individuals from managing corporations. Section 206D, in particular, targets the disqualification of persons from managing companies if, amongst other things, the failure of the company is linked to insolvency and the non-payment of debts.

54) The extent to which directors have been disqualified under Part 2D.6 is, to our knowledge, limited. We hope that the increased and targeted focus on illegal phoenixing activity together with the introduction of DINs will change this.

55) The importance of also establishing that directors of Australian companies are able to speak, read and/or write English is also important. In addition to directors who actually reside outside of Australia for the majority of any given year, we also come across many directors that do not speak English. This calls into question many things including their understanding of the applicable rules and regulations to hold a position as a director in an Australian registered company and also as to the basis upon which they have been able to submit documents, in English, to the relevant regulatory bodies and, moving forward, to the registrar and the persons assisting them.

56) We welcome these reforms, although query the extent to which the information submitted by directors will be scrutinised and whether action will indeed be taken in practice. Again, the resourcing to monitor this is crucial.

SUMMARY

57) We re-iterate the position as stated in previous submissions provided by us in this area.

58) We welcome the proposed reforms but hope that the lack of allocation of resources to counter the conduct that the reforms aim to target does not continue. If the Government, regulators and all other parties with an interest (vested or not) are to really address the issues, then resourcing is crucial and, in our view, will be the difference between whether the reforms achieves its goals or whether they simply merge into and form a part of the multitude of laws and measures that already exist and that which are not being enforced.

59) Most of the recommended provisions to date, have been aimed at protecting tax revenue. We are pleased to see that these latest draft reforms appear to be more focused on improving the quality and integrity of the information available to creditors and the general public. This will assist in the making of accurate credit assessments and decisions as to who to do business with, particularly for SMEs.

60) Currently, we do not know the extent that State Police and/or the Australian Federal Police are involved in the criminal penalties currently provided for and intended to be relied upon moving forward. However, we suggest that the regulatory bodies such as ASIC and the ATO need to work closely with the relevant police force in order to achieve a more holistic approach and to properly combat the conduct to which this and the anti-phoenixing legislation seeks to target.

61) As the vital parts of the new regime remain unknown such as who the appointed registrar will be and what data standards will be introduced and/or applied, we will watch with interest as to how this all evolves.

Date: 26th October 2018

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