**Submission in relation to Exposure Draft - Corporations Amendment (Phoenixing and Other Measures Bill) 2012**

**Submission in relation to Exposure Draft - Corporations Amendment (Similar Names) Bill 2012**

It is pleasing to see the Government's commitment to tackling the vexing problem of phoenix activity. The 2009 Treasury *Phoenix Proposals Paper* canvassing options to address 'fraudulent phoenix activity'[1] estimated that phoenix activity is costing the Australian Taxation Office $600 million per year. Its costs to other creditors have not been reliably estimated but are undoubtedly considerable. The behaviour even affects competitors. Companies which fail to pay taxes, superannuation contributions and employee entitlements can undercut prices in tenders made by law-abiding companies,[2] who may be induced to act in a similar manner if phoenix activity is not detected and prosecuted. A press release in 2011 estimated that there were 6,000 phoenix companies in Australia.[3]

The 2009 Proposals Paper describes as the basic form of phoenixing, a newly incorporated company taking over the business of a previously liquidated entity which has failed to pay its debts.[4] The sophisticated form occurs within corporate groups.[5] Typically under this form, one entity with few assets within a corporate group incurs substantial liabilities by way of wages, superannuation contributions, PAYG or sales tax, and then is liquidated. If they are 'lucky', the employees may be transferred to another entity in the group to continue their employment, without necessarily being paid their entitlements. Taxation authorities, as non-priority unsecured creditors, are left empty handed.

Phoenix activity is highly complex and has an enormous negative economic effect in Australia. Legislation to tackle it therefore needs to be meticulously considered and integrated to ensure that it achieves a set of pre-defined, carefully articulated overall objectives. Because fraudulent phoenix activity has the capacity to mimic quite legitimate and indeed beneficial behaviour – for example, the rescue of a failed business by its former management who then turn the business into a success – any laws to deter the illegitimate version must be balanced against any harm they may cause. This is particularly the case with the sophisticated form of phoenix activity within corporate groups. A 2000 study by Ramsay and Stapledon showed that on average, listed companies had 28 controlled entities.[6] Any legislation to deal with phoenix activity within corporate groups will impact business structures far beyond those against whom it is targeted.

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[1] Australian Government, Treasury, *Action Against Fraudulent Phoenix Activity Proposals Paper*, November, 2009 (hereinafter '2009 Phoenix Proposals Paper'), [1.1].

[2] Commissioner the Hon Terrence Cole commented, in the Final Report of the Royal Commission into the Building and Construction Industry, February 2003 (Cole Royal Commission): 'It is of particular importance that workers receive their lawful entitlements and have adequate mechanisms to recover them when they are not paid. For most workers, their entitlements to wages and associated benefits are their major source of financial support. ... In addition, businesses that do not pay the proper entitlements gain an illegitimate advantage over those that do.' at 137.

[3] The Hon Bill Shorten, Media Release, no 138, 'Protecting Employee Super and Strengthening the Obligations of Company Directors', 13 October, 2011.

[4] Phoenix Proposals Paper, above n 20, [1.1.2]

[5] Ibid.

[6] Ian Ramsay and Geof Stapledon, *Corporate Groups in Australia*, Research Report, Centre for Corporate Law and Securities Regulation, University of Melbourne, 2000. A 2010 study found that 'the vast majority (over 91%) of controlled entities are wholly owned': Sandra van der Laan and Graeme Dean, 'Corporate Groups in Australia: State of Play' (2010) 53 (20(2)) *Australian Accounting Review* 126. 121, 126.

For this reason, it is understandable that the Federal Government, keen to be taking action and anxious not to alarm the business community, has only tackled simple issues, the 'low-lying fruit'. Pursuant to the Corporations Amendment (Phoenixing and Other Measures Bill) 2012, it is indeed beneficial for ASIC to be given powers to appoint a liquidator where a company is abandoned or deregistered. This should enable the liquidator to take appropriate action against directors where there are instances of insolvent trading (s588G), transactions intended to deprive employees of their entitlements (s596AB) or breaches of directors' duties. Liquidators may claw back voidable transactions under Division 2 of Part 5.7B, for the benefit of creditors.

In addition, liquidation also allows employees access to GEERS. This is one of the motivations for the Phoenixing and Other Measures Bill. [7] However it should be noted that ASIC may already apply to the court to place a company into liquidation for the benefit of employees, as it did in the case of On Ground Logistics.[8] The Minister responsible for workplace relations may also exercise their discretion to allow access to GEERS where a company is not in liquidation, as the Hon Julia Gillard did when Minister for the employees of Coastal Express,[9] National Parts [10] and Drivetrain Systems International.[11] The amendment to the law to be brought about by the Phoenixing and Other Measures Bill is an improvement on the present situation as it will simplify and reduce the delays associated with placing a company into liquidation or in seeking ministerial approval, but it is an improvement of form rather than substance. It does not greatly improve the outcomes for ASIC, employees or other unsecured creditors.

In addition, under the present deregistration provisions of the *Corporations Act* [12] ASIC is vested with the property of the company[13] and takes on the powers of the company or a liquidator in satisfying the company's liabilities.[14] Prior to the amendment of these provisions, the Australian Securities Commission's 1996 report into phoenix activity had found that:

> it would appear that approximately 92% of Phoenix companies are deregistered under the ASC's section 574 program.
>
> Effectively the ASC is unintentionally assisting Phoenix offenders to escape prosecution and detection by deregistering the company and closing off the trail. This is particularly the case in circumstances where debts may be many, but small and no creditor action is taken to place the company under administration.[15]

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[7] See Explanatory Document accompanying the release of the legislation; see also the Parliamentary Secretary's press release No 066.

[8] ASIC press release 07-118, 4th May, 2007 http://www.asic.gov.au/asic/asic.nsf/byheadline/07-118+ASIC+takes+steps+to+protect+employee+entitlements?openDocument

[9] http://ministers.deewr.gov.au/gillard/assistance-employees-coastal-express

[10] http://ministers.deewr.gov.au/gillard/assistance-employees-national-parts

[11] http://ministers.deewr.gov.au/gillard/assistance-employees-drivetrain-systems-international

[12] The section has been substantially re-written from the Corporations Law version. This was in part as a result of the recommendation of the Australian Securities Commission, Research Paper 95/01 'Project One: Phoenix Activity and Insolvent Trading Public Version', May 1996, which recommended that 'a detailed examination of the s 574 program's objectives and outcomes be undertaken with a view to addressing phoenix activity'. At 75.

[13] *Corporations Act* s 601AE.

[14] *Corporations Act* s 601AF.

[15] Australian Securities Commission, Research Paper 95/01, 75.

There is no data available from ASIC to determine whether ASIC exercises these powers to prosecute phoenix behaviour by the directors of deregistered companies. It would therefore appear that the Phoenixing Bill, in providing ASIC with an administrative power to order the winding up of a company, aims to shift at least some of the responsibility for detecting and prosecuting phoenix activity from itself to a liquidator. However, where the deregistered companies are without assets, it is questionable whether liquidators will be willing to accept these appointments.

At present, the Corporations Act 2001 contains powers that ASIC can utilise against company directors who misuse their powers by engaging in phoenix activity. Under s 181(1) directors must exercise their powers in good faith in the best interests of the company and for a proper purpose. Under s182(1), directors must not use their position to gain an advantage for themselves or someone else or cause detriment to the corporation. Many of the actions of directors who engage in phoenix activity would amount to breaches of these duties, which can be actioned by ASIC as civil penalty breaches under Part 9.4B of the Act. ASIC can seek pecuniary penalties, compensation and disqualification of the director. In addition, directors breaching these duties recklessly or with intentional dishonesty may be subject to criminal proceedings and penalties of up to $220,000, 5 years imprisonment or both. Importantly, ASIC's right to take action does not depend on the company's status as a going concern or on the form of its external administration. Therefore, the Phoenixing Bill does not improve ASIC's ability to pursue directors for breaches of directors' duties.

The comment was made above that the appointment of a liquidator allows action to be taken under s596AB against directors entering into transactions with the intention of preventing the recovery of the entitlements of employees of a company, or significantly reducing the amount of the entitlements of employees of a company that can be recovered. According to the Explanatory Memorandum which preceded the enactment of the *Corporations Law Amendment (Employee Entitlements) Act 2000*[16] the object of s 596AB was 'to deter the misuse of company structures and of other schemes to avoid the payment of amounts to employees that they are entitled to prove for on liquidation of their employer'.[17] Yet the section has never been effectively used.

This should come as no surprise. The legislation had its second reading speech on 17 February 2000.When debate resumed on 9 March, the Labor Opposition quickly expressed their disappointment with the legislation, and the difficulty of needing to prove an intention to deprive employees of their entitlements was pointed out.[18] The Bill was referred to the Parliamentary Joint Statutory Committee on Corporations and Securities.[19] Numerous

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[16] Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000, available at: http://www.comlaw.gov.au/Details/C2004B00639/Explanatory%20Memorandum/Text

[17] Ibid [18]. Section 588G was also amended to allow uncommercial transactions under s588FB to be pursued as insolvent trading. The Explanatory Memorandum acknowledged that: 'The inclusion of uncommercial transactions in s 588G(1A) has implications for the protection of employee entitlements, the prosecution of directors involved in "phoenix" activity and recovery actions by liquidators for the benefit of creditors generally.' Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000 (Cth) [10].

[18] Commonwealth, *Parliamentary Debates*, House of Representatives, 9 March 2000, 14301-2 (Kelvin Thompson); Commonwealth, *Parliamentary Debates*, House of Representatives, 15 March 2000, 14804 (Dick Adams).

[19] Commonwealth, *Official Committee Hansard*, Joint Committee on Corporations and Securities, Reference: Corporations Law Amendment (Employee Entitlements) Bill 2000, Wednesday 5 April 2000, Canberra.

objections were made.[20] One submission noted that the provisions would be a 'toothless tiger', that will be 'so hard to prove that no one will be effectively prosecuted.' [21] The New South Wales Attorney General and Minister for Industrial Relations, the Hon JW Shaw QC MLC argued strenuously against the criminal standard of proof and the need to prove intention, suggesting instead that it be replaced with 'effect'.[22]

As predicted, the legislation proved ineffective. The Parliamentary Joint Committee on Corporations and Financial Services in their 2004 in their *Corporate Insolvency Laws: A Stocktake* [23] devoted a chapter to phoenix activity. A series of recommendation were made including that the 2000 legislation be reviewed and

> in light of the evidence suggesting that some corporations deliberately structure their business to avoid paying their full entitlements to employees and more generally unsecured creditors, the Committee recommends that the review look beyond the effectiveness of the Act and consider, and offer advice on, possible reforms that would deter this type of behaviour.

Yet little was done. The Joint Committee of Public Accounts and Audit in 2008 noted an increase in the numbers of individuals promoting the benefits of fraudulent phoenix activity.[24] The 2009 Phoenix Proposals Paper acknowledged that '[i]t is clear that ... existing mechanisms do not provide a sufficient disincentive to prevent fraudulent phoenix activity.'[25] This is undoubtedly true. In the Federal Court in October, 2011,[26] Buchanan J spoke of the 'interpositioning' of an assetless company between employees and their true employer, 'for the purpose of avoiding direct legal responsibility for the wages and entitlements of employees. ... A purpose of that kind does not mean, necessarily, that arrangements are ineffective, much less illegal.'

The Government must therefore acknowledge that more needs to be done than the present two Bills are proposing to do. The second piece of proposed legislation, the Similar Names Bill, provides that a director of a failed company can be jointly and individually liable for the debts of a company that has a similar name to the pre-liquidation name of the failed company. This follows the example of several overseas jurisdictions, such as the United Kingdom[27] and New Zealand.[28] A similar name is sometimes used for the phoenix company so that customer goodwill can be maintained and cheques payable to the previous entity can be banked in the new company's bank account.

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[20] Parliament of Australia, Parliamentary Joint Statutory Committee on Corporations and Securities, *Report on the Corporations Law Amendment (Employee Entitlements) Bill* 2000, (hereinafter Parliamentary Joint Statutory Committee Report), [3.34], available at <http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/1999-02/employee/report/report.pdf>, chapter 3.

[21] The Shop, Distributive and Allied Employees' Association, ibid [3.25]. The ACTU also opposed the intention requirement, arguing that it was 'an impossible burden that significantly reduced the effect of the section'. Ibid [3.21]. A similar view was also taken by the Textiles, Clothing and Footwear Union of Australia (Vic Branch) (ibid [3.27]) and the Australian Catholic Commission for Industrial Relations (ibid [3.28]).

[22] Parliamentary Joint Statutory Committee Report, above n 20, [3.22] – [3.23].

[23] Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004), Chapter 8, Recommendation 43.

[24] Parliament of Australia, Joint Committee of Public Accounts and Audit July 2008, Report 410 into Tax Administration, Canberra, [2.48].

[25] 2009 Phoenix Proposals Paper, above n 1 [3].

[26] *Fair Work Ombudsman v Ramsey Food Processing Pty Ltd* [2011] FCA 1176, [3].

[27] *Insolvency Act 1986* (UK) s 216.

[28] Companies Act 1993 (NZ) s386A.

As with the Phoenixing Bill, the Similar Names Bill is a useful improvement if it deters this behaviour, but its limitations are clearly evident. It does nothing to prevent phoenix behaviour where a different name is used for the new company. Indeed, where a company has become notorious in an industry for non-payment of its creditors, its former directors may be compelled to start its successor under a completely different name to enable it to obtain supply of goods and services.[29] The Similar Names Bill does nothing to prevent the incorporation of a new entity with a similar name to the failed company where a related party of director of the failed company, for example a spouse, child or sibling, is appointed director instead. The banking of cheques payable to the previous entity would clearly be actionable as a misuse of position under s182(1) and the proposed legislation is not needed to prosecute such behaviour.

In addition, the Similar Names Bill avoids the more complex area of voluntary administration (VA) . Under the Similar Names Bill, either the court or a liquidator can make a determination that a person is exempt from s596AJ, which is the section imposing personal liability on the director for the debts of the debtor company (the new, phoenix entity). The Bill does not address the situation where a failed company has entered VA, and the company has been saved via a deed of company arrangement (the DOCA, which contains the compromise reached with creditors). Saving the business is indeed the primary objective of VA. Section 435A provides that:

> The object of [Part 5.3A] is to provide for the business, property and affairs of an insolvent company to be administered in a way that:
>
> (a) *maximises the chances of the company, or as much as possible of its business, continuing in existence;* or
>
> (b) if it is not possible for the company or its business to continue in existence--results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

The mechanism by which phoenix activity is supposedly avoided in VA is the requirement that the DOCA is voted on by creditors. If they are not satisfied with the deal they are being offered under the Deed, creditors have the option to vote to have the company wound up,[30] and the company's affairs are then placed in the hands of a liquidator. However, there is the possibility that phoenix activity may still be taking place where the controllers of the company are its principal lenders. This is often the case in small family owned companies. Their votes carry the DOCA through, even though the other creditors object to it. It is too early to say whether the resurrection of the Chris and Marie's Plant Farm Group, placed into administration on 7th November 2011and returned to the hands of its owners on 24th December 2011, is one such company. Newspaper reports[31] indicate that the votes of related parties were responsible for the acceptance of the DOCA and that non-related-party creditors are expecting to receive only 6 cents in the dollar.

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[29] An example of this is the liquidated Beaver Press Sales Pty Ltd, whose director, Robert Francis, was prosecuted by the Fair Work Ombudsman for failure to pay wages and annual leave entitlements (*Fair Work Ombudsman v Francis*, 19 December 2011, Federal Magistrates Court, Sydney). It is alleged that Francis has commenced another business of the same nature on the same premises through another company – Goodcrowd Integrated Print Communications Pty Ltd – of which Francis is the sole director and majority shareholder.

[30] *Corporations Act* s 439C (c).

[31] See http://www.smh.com.au/small-business/managing/fury-as-nursery-to-repay-only-6162-in-dollar-20120111-1pu6d.html, 11th January, 2012.

This is not to suggest that the Similar Names Bill facilitates the phoenixing of companies placed into VA. Rather, it does not address the issue in any way. Section 600A already allows the court to set aside the decision of the second creditors' meeting on the DOCA where the outcome has been determined by votes cast by related entities. But just like the other mechanisms already available to ASIC and other parties to deal with phoenix activity, such as the directors' duties provisions, there needs to be an application to the court. This is expensive and time-consuming, and creditors already facing non-payment of their debt may be concerned at investing money in such an application. One advantage of the Similar Names Bill is that the directors face liability for the new company's debts, *unless* they have received an exemption from a liquidator or from the court, based on a belief that the person has acted honestly and having regard to all the circumstances, ought fairly to be exempt. The onus here appropriately is on the director to obtain such a dispensation. The Government ought to consider whether this sort of mechanism could be adapted to deal with the circumstances of phoenixing in the context of VA. After all, it is the directors who are asking for a second chance. Creditors are already to some extent out of pocket. Why should they be put to the additional expense of a court application under s 600A to overturn the DOCA?

Upon the release of the two Bills, the Parliamentary Secretary to the Treasurer, the Hon David Bradbury, made the following claims:

> These amendments will crack down on 'phoenixing', where directors try and avoid having to pay workers' entitlements and other unsecured creditors by restarting their failed business using a similar company name, sometimes located in the same premises with the same staff and clients.
>
> Under these proposals, directors of a failed company can be held liable for the debts of a company that has a similar name to a pre-liquidation name of the failed company - otherwise known as a phoenix company.
>
> This will stop directors from exploiting the limited liability protections in the corporations law to avoid having to pay any debts, including workers' entitlements, that they incur in a 'phoenix' company.
>
> This will ensure that directors cannot keep racking up debts through multiple 'phoenix' companies and escape their obligations to pay workers' entitlements and other creditors.

These claims are not justified. The proposed legislation makes some slight inroads in the case of basic phoenixing but does nothing about sophisticated phoenixing in corporate groups. In 2010, legislation made small improvements to the director penalty notice regime and extended the ATO's ability to seek security bonds, but attempts to extend the DPN regime to cover unremitted superannuation contributions and to automate DPNs was rejected at the end of 2011. Nothing has been done or proposed to be done to tackle phoenix activity within corporate groups to protect employee entitlements or the rights of other unsecured creditors.

**The Government is urged to look at the phoenix company problem more broadly, and this submission makes three recommendations:**

1. The Government needs to ask whether the present directors' duties provisions are adequate or not. There seems to be a presumption that since phoenix activity is continuing, these laws must somehow be unable to tackle it, and that therefore new legislation must be enacted. But

the rarity of prosecutions[32] may not be indicative of inadequacy if the issue is actually the lack of ASIC resources to take action. The passage of further legislation will make no difference to the incidence of phoenix activity if ASIC has no additional capacity to follow up its breaches.

Since 2008, external administrators – receivers, administrators and liquidators – have filed reports with ASIC to indicate their suspicions of director misbehaviour.[33] These reports are then divided up into tables showing reports of breaches of particular sections, and of those, where the liquidator holds evidence.[34] Only general data is available as to what happened in relation to those reports. In 2009-2010, there were 5,438 reports of possible misconduct comprising a total of 14,652 alleged breaches.[35] These reports resulted in ASIC asking external administrators to prepare supplementary reports for 600, or 11%, of these 5,438 reports. The purpose of the supplementary report is to provide ASIC with more detail to see whether the reported conduct warrants further investigation.[36]

Documentary evidence of the breaches was held by external administrators in 3,263 reports, but they recommended action in only 885 of those cases. ASIC requested supplementary reports for 335 of these, in part based on the size of the deficiency of assets within the company.[37] This appears to suggest that if ASIC were given more resources, more of these reports of documented misconduct might be investigated. In terms of action taken, ASIC states that 'recovery proceedings ... for the benefit of creditors ... either had been initiated *or their initiation had been considered* in 1,421 (18%) of all reports.'[38] To find more definite data, one must look in the ASIC Annual Report. This shows 23 criminal prosecutions, with 22 convictions and 12 jailed. In addition, ASIC 'completed 30 civil proceedings and obtained more than $287million in recoveries, costs and fines. ... ASIC was successful in 94% of civil litigation and 80% of criminal matters'.[39] ASIC also banned 70 company directors for insolvency-related offences,[40] with 42 of these based on reports from liquidators who received Assetless Administration Fund (AAF) funding.[41]

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[32] An example is *R v Heilbronn* (1999) 30 ACSR 488 where the director of a company with substantial sales tax liabilities stripped the company of its assets and transferred them to another company, and then to a third company. On each occasion, the same business was carried under the same trading name. A proper price was not paid for the assets and no effort was made to ensure that liabilities and legal obligations under the *Corporations Act* had been met. The director, Heilbronn, was found to have knowingly and intending to defraud the creditors of the second company, made an improper use of his position as officer to cause detriment to that company and was sentenced to two years imprisonment. where the New South Wales Supreme Court found eight directors to have acted in breach of sections 181(1), 181(2) and 181(3) of the *Corporations Act* by engaging in illegal phoenix activity. Their solicitor, Mr Timothy Somerville, also contravened s 79 of the Corporations Act as a person involved in the contravention of the Act, as he aided and abetted the directors in their breaches

[33] Report 225 Insolvency Statistics: External Administrators' Reports 1 July 2007 – 30 June 2010, available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep225.pdf/$file/rep225.pdf. Misconduct was not reported in the data in Report 225 for 2007-2008.

[34] Ibid Table 18

[35] Ibid [39].

[36] Ibid [40].

[37] Ibid [45]. Of the 550 reports which were not followed up, only 52 related to deficiencies of $5million or more. For deficiencies between $5million and $10million, ASIC requested supplementary reports in 41.5% of cases, and for deficiencies over $10million,in 78.3% of cases.

[38] Ibid [97] (emphasis added).

[39] ASIC Annual Report, 2009-2010, 16.

[40] Ibid 17.

[41] Ibid 37.

In terms of enforcement of the law, the terms under which funding may be requested from the AAF may need to be revisited. The aim of the fund is to overcome the reluctance of liquidators to take action due to financial constraints. However, one of the AAF funding criteria is that an initial report[42] must be lodged by a liquidator.[43] The scheme therefore relies on action being taken by a liquidator in the first place. Funding, which is capped, is only available for investigations where s 206F director banning proceedings may be appropriate, or where court proceeding for serious misconduct pursuant to the *Corporations Act* may be warranted.[44] While the Regulatory Guide indicates that '[a] particular focus of the AA Fund is to curb fraudulent phoenix activity',[45] it is not available for actions for the recovery of assets.[46] Why should the liquidator be spending their time and risking their money on looking for breaches of the law for ASIC to prosecute, when their role is to recover assets for the benefit of creditors?

Moreover, AAF funding is only provided if the initial report indicates sufficient evidence exists to support the allegations made.[47] This is surely a 'chicken and egg' argument: access to the fund depends on a liquidator of a company, which by definition is assetless, being willing to make investigations at their own expense to come up with the evidence sufficient to support their application for funding. It was this very reluctance to expose themselves to personal expense that the AAF was set up to overcome.[48]

In terms of allocating more funds to detection of phoenix activity, the comments of Commissioner Cole in the Building and Construction Royal Commission should be recalled:

> There has been significant incidence of fraudulent phoenix company activity in the building and construction industry. Since 1998 the Australian Taxation Office has raised at least $110 million in taxes and penalties from the detection of fraudulent phoenix company activity in the building and construction industry. *For every $1 spent by the Australian Taxation Office on the detection of phoenix company activity in the period 1 July 2001 to 30 June 2002 $8 in revenue was raised.*[49]

This is not to suggest that a similar result would necessarily be achieved by ASIC. Indeed, much of the money recovered by ASIC would be made available to creditors, and would not be used to fund the Government's detection activities. However, to the extent that these recoveries related to employee entitlements which had been paid out by the Government under GEERS, the sums would be returned to the Government via their right of subrogation.

2. If it is concluded that the present legislation is inadequate, that inadequacy must be carefully identified. The present s596AB would be an obvious target for revision, given its

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[42] *Corporations Act 2001* s 533.
[43] Regulatory Guide 109: Assetless Administration Fund: Funding Criteria and Guidelines, November, 2009, RG109.19, available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/RG109.pdf/$file/RG109.pdf.
[44] Ibid RG109.20
[45] Ibid RG109.4.
[46] Ibid RG109.21
[47] Ibid RG109.22
[48] Given these constraints, it is not surprising that large amounts of funds remain unallocated. In 2006 $23 million was allocated over four years to the fund. As at June, 2010, $9.1 million had been spent. ASIC Insolvency Update, June 2010, available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC%20Insolvency%20Update%20201006.pdf/$file/ASIC%20Insolvency%20Update%20201006.pdf
[49] The Hon Terrence Cole, Final Report of the Royal Commission into the Building and Construction Industry, February 2003 (Cole Royal Commission), recommendation 108. (emphasis added).

lack of use and the extensive criticism of its intention requirement. The Government should consider reintroducing the provision as a civil penalty breach. This possibility was raised in the early days of the House of Representatives' debate of the Corporations Law Amendment (Employee Entitlements) Bill.[50] The Hon Kelvin Thompson said:

> I understand that the government drafted the new section 596AB as a criminal offence, thus it was considered appropriate that the actual intention of a director be proved. However, because it is a criminal offence, not only must the actual intention be proved but it also must be proved beyond reasonable doubt. It was not necessary that section 596AB be drafted in that particular way. To compare again section 596AB with the insolvent trading provisions, section 588G is a civil penalty provision, which means not only is there an objective or reasonable person test but also that it needs to be proved on a balance of probabilities. A director can still be guilty of a criminal offence if it can be shown that the director contravened the provision knowingly, intentionally, recklessly dishonestly or with the intention to deceive or defraud. ...
>
> The contravention of section 596AB could still be a criminal offence if breached with the requisite intention , but as a civil penalty provision employees would have a greater likelihood of succeeding in recovering compensation from directors.[51]

3. The Government should look overseas more widely for solutions to the problem. The Similar Names legislation is a good start but is easily avoided by choosing a different name. In relation to the basic form of phoenixing, the Government should note that Ireland requires directors who have run companies against whom adverse liquidators' reports have been lodged[52] to ensure that a large amount of equity capital *in cash* is invested in the new company or to prove in court why they should not be required to do so. This reverse onus relieves the detection and compliance burden on their regulator.[53] The relevant parts of s150 of the Companies Act 1990 (Ireland) are as follows:

> 150.—(1) The court shall, unless it is satisfied as to any of the matters specified in subsection (2), declare that a person to whom this Chapter applies shall not, for a period of five years, be appointed or act in any way, whether directly or indirectly, as a director or secretary or be concerned or take part in the promotion or formation of any company unless it meets the requirements set out in subsection (3); and, in subsequent provisions of this Part, the expression "a person to whom section 150 applies" shall be construed as a reference to a person in respect of whom such a declaration has been made.
>
> (2) The matters referred to in subsection (1) are—
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> (a) that the person concerned has acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be subject to the restrictions imposed by this section, or
> (b) ..... or
> (c) .....

[50] Commonwealth, Parliamentary Debates, House of Representatives, 9 March 2000, 14302 (Kelvin Thompson).
[51] Ibid.
[52] Companies Act 1990 (Ireland) s 149.
[53] Companies Act 1990 (Ireland) s 150; Company Law Enforcement Act (Ireland) 2001 s 56.

> (3) The requirements specified in subsection (1) are that—
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> (a) the nominal value of the allotted share capital of the company shall—
> (i) in the case of a public limited company, be at least £100,000,
> (ii) in the case of any other company, be at least £20,000,
> (b) each allotted share to an aggregate amount not less than the amount referred to in subparagraph (i) or (ii) of paragraph (a), as the case may be, *shall be fully paid up*, including the whole of any premium thereon, and
> (c) each such allotted share and the whole of any premium thereon *shall be paid for in cash*.[54]

This may not be the whole answer, of course. Unless the company was required to hold this share capital in trust in some way, it could be expended and lost in the operations of the business, and creditors would be no better off. A personal guarantee might work better, except that it could be defeated by the personal bankruptcy of the individual director. Asking for the payment of a bond, to be held by ASIC, would immediately bring about complaints about removing scarce capital from the business, yet it should be remembered that in 2010, the Commissioner of Taxation's ability to require security bonds to be payable by suspected phoenix companies was improved. This sort of requirement therefore is not without precedent, and these options, including the Irish legislation, should be examined by the Government.

In relation to the sophisticated form of phoenixing within corporate groups, the Government should consider the United States and Germany, which both have laws subordinating parent debt, where subsidiaries are set up undercapitalised but have their operations are financed by credit (often secured) from the parent company. Interestingly, these two countries treat this problem in different ways. In 2008, Germany substantially overhauled its relevant laws.[55] In addition, New Zealand and Ireland both allow for courts to make orders against solvent holding companies to contribute to the debts of insolvent subsidiaries where it is just and equitable.[56]

Conclusion

The Federal Government is right to accept its responsibility to tackle phoenix activity, which hurts its own revenue streams as well as the economic wellbeing of employees and creditors of companies. While the proposed legislation is unlikely to do any harm, it falls far short of what is required to make deep inroads into the problem. The existing directors' and officers' duties clearly deal with the types of actions typically taken in phoenix circumstances, and carry harsh penalties, including imprisonment for intentionally dishonest or reckless breaches. Serious thought needs to be given to why these laws are not sufficient, or whether there are issues of enforcement that should first be addressed.

New legislation may indeed assist in deterring phoenix activity and in prosecuting when it occurs. The avoidance of employee entitlements should be dealt with by a re-working of the

[54] Emphasis added.
[55] Gesetz zur Modernisierung des GmbH-Rechts und Zur Bekämpfung von Missbräuchen (Law for the Modernisation of the GmbH and to Stop its Misuse). See Dirk A Verse, 'Shareholder Loans in Corporate Insolvency – A New Approach to an Old Problem' (2008) 9 *German Law Journal* 1109, 1112-21.
[56] Companies Act, 1993, s.271(1) (NZ); Companies Act, 1990, (Ireland) s.140

never-used s596AB. In addition, directors of failed companies should have the onus of showing why they should be given the privilege of running another limited liability entity, rather than the onus being on ASIC to seek their banning. While this inevitably leads to cries that business enterprise will be hindered, it is essentially what the Similar Names Bill is doing. However, it is absurd to limit such a requirement to the easily-avoidable circumstance of saving a similar name to the failed company.

In addition, the Government needs to accept the Treasury Phoenix Proposal Paper's advice that phoenix activity is not limited to successor companies, but also occurs within corporate groups. The present Bills do nothing in these circumstances. A proper inquiry needs to be made into the various mechanisms available internationally which pierce the corporate veil to make holding companies liable to contribute to the debts of their insolvent subsidiaries or to subordinate repayment of subsidiary debts owed to them until external creditors are paid.

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19th January, 2012