ACCESS TO JUSTICE: THE TROUBLED PATH FOR VICTIMS OF ILLEGAL PHOENIX ACTIVITY

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I INTRODUCTION

Access to justice is usually viewed in terms of the practical impediments faced by plaintiffs seeking redress for civil wrongs. These include issues of cost and complexity, and the structure of the legal system including scope for private settlement of disputes. In September 2014, the Productivity Commission handed down its report into access to justice arrangements.¹ It made a series of valuable recommendations concerning consumers’ lack of information about avenues of redress, the value of early and informal solutions, problems with the formal system of justice, and access to justice for disadvantaged people.²

This paper is prompted by the tenor of the Productivity Commission’s report as well as its later inquiry into Business Set-up, Transfer and Closure in December 2014.³ It takes a different approach to the traditional access to justice investigation by considering the issue in the context of a specific cause of loss – illegal phoenix activity. While not defined in the Corporations Act, illegal phoenix activity occurs when company controllers close down one company with unpaid debts and transfer its assets for undervaluation to a newly created company, with the intention of exploiting the corporate form to the detriment of the creditors of the defunct company.

This area of insolvency law has a number of unusual features which are relevant to access to justice: the collective distribution regime that deprives individuals of their rights to bring separate actions; the fact that an insolvent company, by definition, lacks sufficient funds to pay all claimants; general ignorance about rights under complex corporate law; underfunded liquidators, reluctant to initiate legal action, who are nonetheless acting on behalf of vulnerable creditors; the blurring of lines between legal and illegal behaviour that complicates the situation for whoever brings the action; the lack of a specific ‘phoenix’ offence; the apparently unassailable nature of the separate legal status of companies and the limited liability of its shareholders; a taxpayer funded scheme for employees of insolvent companies that arguably negates the need for separate recovery mechanisms; and economic dogma that celebrates business triumph after business failure. How do the victims of illegal phoenix activity – revenue authorities, employees, small trade creditors, competitors and customers – get justice, or are they simply economic collateral damage?

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² Ibid, 41-72.

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The loss suffered by unsecured creditors of companies that have been phoenixed is the non-payment of their debts. There are a number of reasons why creditors have difficulty obtaining access to justice in order to address this grievance. However in an area where justice equates to payment, their loss could be lessened if the pool of funds available for distribution to unsecured creditors in insolvency was increased. This result could be achieved by the imitation of a successful claim against the directors of phoeniced companies by either the liquidator or the Australian Securities and Investments Commission (ASIC).

This paper is in six parts. Part II examines illegal phoenix activity. Part III sketches its victims of illegal phoenix activity, Part IV considers what enforcement mechanisms exist to tackle illegal phoenix activity, and it will be seen that this very much depends on who the victim is. Part V asks what access to justice means for these victims and should a public regulator such ASIC use its enforcement mechanisms to assist creditors? Part VI concludes that in certain circumstances seeking compensation from directors of phoeniced companies in order to facilitate greater access to justice for unsecured creditors is an appropriate use of its resources.

II WHAT IS ILLEGAL PHOENIX ACTIVITY?

A phoenix company is one that arises from the ashes of its defunct former self. There are a variety of definitions used by regulators and other stakeholders but none that is universally accepted. While the term ‘phoenix company’ can be used to describe the perfectly legal, even desirable, rescue of a viable business, generally it is used in a pejorative sense to capture some aspect of impropriety on the part of the defunct company’s controllers. Illegal phoenix activity involves company controllers closing down one company in order to leave its debts unpaid within that defunct business, and then transferring ‘the business’ – assets, goodwill, premises, possibly a similar name – to a newly created company. The intention is to exploit the corporate form to the detriment of unsecured creditors, including employees and tax authorities. The failed company is left without the means to meet its obligations.

The illegality stems from this improper intention. It is a breach of a director’s duty to act for a proper purpose, and not to misuse their position to make a gain for themselves or someone else or cause detriment to the company. If the transfer of assets from the failed company for undervalue constitutes an uncommercial transaction directors may also breach the duty to prevent insolvent trading. These duties are civil penalty provisions and are actionable by both the liquidator, on behalf of creditors, and ASIC as the corporate regulator, but not by the victims of this behaviour.

Several aspects of illegal phoenix activity are of particular relevance to its victims. First, the very act of stripping assets from the failing company deprives its creditors of assets against which the liquidator can recover on their behalf. Second, not all failed companies are liquidated, because the costs of liquidation must be met from the company’s assets. Where there are no assets, liquidators have no incentive to accept the engagement. The Government’s Assetless Administration Fund (AAF) has been set up with the purpose of

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5 Corporations Act 2001 (Cth) s 181, s 182.
6 Corporations Act 2001 (Cth) s 588G.
paying for assetless administrations. The operation of this fund is discussed further in Part V below.

III WHO ARE THE VICTIMS OF ILLEGAL PHOENIX ACTIVITY?

One of the interesting and challenging aspects of obtaining justice for those affected by illegal phoenix activity is the variety of its victims. Those to suffer most are the ATO and its state revenue office (SRO) counterparts. The ATO is responsible for gathering taxes such as income tax, including Pay-As-You-Go deductions withheld from employees’ pay packets (PAYG(W)), as well as the superannuation guarantee charge (SGC) which is levied on employers who fail to make super contributions to employees’ nominated funds. The state revenue offices gather taxes such as land tax and payroll tax. Each of these taxes is susceptible to non-payment through illegal phoenix activity because the primary liability falls on the failed company and not on its controllers or shareholders. These victims are also regulators with their own enforcement powers, discussed below, designed to protect the revenue they gather.

Employees are significant victims of illegal phoenix activity because their unpaid wages, leave entitlements, payments in lieu of notice and redundancy entitlements are often sizable debts of the failed company. However, it should be remembered that where a company is deliberately liquidated to shed debts, the employees are likely to lose not only their entitlements but also their employment. While the newly created company may take on some or even all of the defunct company’s employees, those employees have no legal rights to demand that it does so. Indeed, shedding employees and forcing them to seek government advances, discussed below, to cover their entitlements may be the reason that motivates the company’s closure. This has relevance in considering what ‘access to justice’ means for employees.

Trade creditors are frequently the victims of illegal phoenix activity. These include suppliers of goods or services to the failed company. Unlike lenders owed large amounts who seek security over the company’s assets or a personal guarantee from company controllers, trade creditors may not seek any security from the company either because their debts are relatively small or because they lack the bargaining power to insist upon it. Therefore they are likely to recover little or nothing after the liquidation process has been completed. However, some trade creditors may be treated more favourably, especially if the newly formed company needs to continue purchasing from that supplier. This commonly occurs through secret arrangements where the new company or its controllers pay the amount owed by the defunct company. This is unjust to those creditors who will receive nothing. Customers of the failed company who have prepaid for goods or services fall into this same category.

Competitors of the phoenix company are the final group of victims of illegal phoenix activity. Some companies tender for work based on their intention to liquidate, leaving the unpaid debts of taxes, wages and supplies quarantined within the failed entity. They then commence business again and repeat the process. Law-abiding competitors are undercut in this cheaper tendering and may genuinely be driven out of business. This may lead to them also engaging in illegal phoenix activity through their next company.

IV WHAT ARE THE MAIN RECOVERY AVENUES FOR VICTIMS OF ILLEGAL PHOENIX ACTIVITY?

Unlike the enforcement of claims against solvent companies, debt recovery against insolvent companies is through the process of liquidation. The company is a separate legal entity, so the debts that it incurs are the debts of the company and not of its directors, managers or shareholders. Moreover, shareholders enjoy limited liability, meaning that they are not liable to contribute further funds to the company once their shares are fully paid.\(^8\) Once a company has entered liquidation, the rights of individual creditors to recover from the debtor company are stayed\(^9\) and their claims, and the claims of other unsecured non-prioritised creditors,\(^10\) are paid by the liquidator from a pool of funds once the assets of the company are collected and realised.\(^11\)

Nonetheless, the avenues for recovery of unpaid amounts largely depend upon who the victim is. Where the victim is a revenue authority, the roles of victim and regulator with powers to seek recovery are combined. The ATO and SROs can, like other unsecured creditors, prove their debts in the liquidation of the company and receive a pro rata payment of the amount owed. However, the ATO in particular has a suite of other tools that it can use to recover from the directors of the company personally. For example, directors who fail to cause their company to remit PAYG(W) taxes or pay superannuation can be subject to personal liability for these amounts if they do not promptly place the company into liquidation or voluntary administration.\(^12\) This is available to the ATO whether or not the directors had an improper intention in failing to remit the amounts on behalf of the company. The ATO may also seek a security bond where there is a suspicion that tax may not be remitted in future.\(^13\) The SROs have powers to recover tax debts owed by insolvent companies from other solvent companies within a corporate group.\(^14\)

Employees are priority creditors in the liquidation\(^15\) and are also the beneficiaries of a reasonably generous taxpayer-funded scheme. In addition, employees have a degree of support from ‘champions’ such as their trade union and the Fair Work Ombudsman (FWO). However, this does not necessarily mean that employees are fully compensated for what they are owed. The statutory priority is only useful where an employer company has some assets remaining after paying the costs of the liquidation but is cold comfort where the assets of that company have been sold for inadequate consideration to a new company. The taxpayer funded scheme, currently in the form of the Fair Entitlements Guarantee (FEG), partly makes up for that deficiency but is subject to limits.\(^16\) The FWO may commence action against the errant employer for failure to pay wages as a breach of the *Fair Work Act 2009* \(^17\) as well as against the company’s controllers for their involvement in this breach.\(^18\) However, such

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\(^8\) *Corporations Act 2001* (Cth) s 516.
\(^9\) *Corporations Act 2001* (Cth) s 471B.
\(^10\) See *Corporations Act 2001* (Cth) s 555 and s 556.
\(^11\) *Corporations Act 2001* (Cth) s 477.
\(^12\) *Taxation Administration Act 1953* (Cth) Sch 1 s 269-15.
\(^13\) *Taxation Administration Act 1953* (Cth) Sch 1 s 255-100.
\(^14\) See, eg, *Payroll Tax Act 2007* (Vic) s 81; *Payroll Tax Act 2007* (NSW) s 81
\(^15\) *Corporations Act 2001* (Cth) s 556.
\(^17\) *Fair Work Act 2009* (Cth) s 45 – contravening a modern award; s 50 – contravening an enterprise agreement.
\(^18\) *Fair Work Act 2009* (Cth) s 550.
action is subject to the FWO’s own resource constraints regarding litigation, and is not a means by which the employee victims of illegal phoenix activity can recover the amounts owing to them. Unions have the right to bring actions for enforcement of some provisions of the Fair Work Act but are themselves subject to resource constraints.

Trade creditors and customers who have made prepayments, by comparison, are friendless. As noted above, they lack the ability to sue once the company has entered liquidation, and the recovery of amounts owing to them are in the hands of the liquidator. The process itself is usually initiated by the debtor company being issued a statutory demand to pay that remains unsatisfied at the end of 21 days, where the company has not applied to have it set aside. A creditor can apply to have the company wound up in insolvent which the court may then order. A liquidator is appointed, and is given a wide variety of powers to gather together the company’s assets for the purpose of distributing them in accordance with the priorities specified in the Act. However, it is often the case that the failed company does not enter liquidation.

V ANALYSIS – ACCESS TO JUSTICE FOR VICTIMS OF ILLEGAL PHOENIX ACTIVITY

The foregoing discussion has highlighted the special difficulties faced by victims of illegal phoenix activity. This part of the paper contains three main strands of analysis. The first considers what ‘justice’ means for these victims; the second examines the many practical hurdles faced by victims when attempting to obtain that justice; and the third examines the extent to which regulators should assist victims of illegal phoenix activity.

A What Does Access to Justice Mean for Unsecured Creditors of Phoenixed Companies?

There is no universally accepted definition of ‘access to justice’. The traditional, narrow view is that the concept is limited to concerns about access to the courts and/or legal assistance. However, most commentators accept that it is not sufficient to concentrate solely on obtaining access to legal processes because this will ‘not necessarily lead to results that are individually or socially just.’ Access to justice is seen by some as involving three key

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19 See FWO, Guidance Note 1 - Litigation Policy.
20 In rare instances, the penalty ordered can be payable to the employees; see Fair Work Act 2009 (Cth) s 545.
21 Fair Work Act 2009 (Cth) s 539.
22 Corporations Act 2001 (Cth) s 471B. Note, however, the ability to seek leave from the court to commence proceedings despite the liquidation. This might occur where the remedy sought is not financial but rather an injunction against the failed company. See, eg, Commissioner for Consumer Protection v Unleash Solar (in liq) Pty Ltd [2015] FCA 348.
23 Corporations Act 2001 (Cth) s 459C, s 459G.
24 Corporations Act 2001 (Cth) s 459P.
25 Corporations Act 2001 (Cth) s 459A.
26 Corporations Act 2001 (Cth) s 477
27 Corporations Act 2001 (Cth) s 566.
Accessed 8 June 2015.
30 Parker, above n 28, 30.
elements or ideals: equality of access to legal services; national equity; and equality before the law.\textsuperscript{31}

Equality of access to legal services is achieved by ensuring that all citizens, who have an arguable case, have a range of opportunities to bring and settle legal proceedings, regardless of individual means.\textsuperscript{32} This requires consideration of the availability of alternative dispute resolution processes\textsuperscript{33} as well as issues relating to costs, litigation funders and class actions.\textsuperscript{34} National equity requires all citizens, regardless of location, to be able to access legal services.\textsuperscript{35} Equality of access before the law ensures that personal aspects such as race, ethnicity, gender or disability do not adversely impact on individual’s ability to access the law.\textsuperscript{36}

Four waves of access to justice reform dominated the literature between the 1960’s and the 1990’s.\textsuperscript{37} Those four waves focused on increasing the availability of legal aid; the need to modify legal processes and procedural rules which were seen to favour the rich and organised; the introduction of alternatives to traditional forms of justice such informal courts, tribunals and alternative dispute mechanisms; and the recognition of a need to allocate legal resources efficiently, via the implementation of competition policies.\textsuperscript{38}

In 2009 the then Attorney General, Robert McClelland said that access to justice encompasses wider concerns than simply access to courts and legal aid. It ‘involves an appreciation and understanding of the needs of those who require the assistance of the legal system.’\textsuperscript{39} Adopting a wide definition in its 2014 report, the Productivity Commission said that the notion of access to justice was concerned with ‘making it easier for people to resolve their disputes.’\textsuperscript{40} Parker argues that ‘justice should be understood as those arrangements by which people can (successfully) make claims against individuals and institutions in order to have security against being dominated by others.’\textsuperscript{41} It has also been described as the ability to seek and obtain a remedy for grievances.\textsuperscript{42}

Directors’ of phoenixed companies are able to dominate and usurp the rights of creditors by misusing the corporate form in a manner that results in creditors not being paid what they are rightfully owed. The ability of creditors of phoenixed companies to receive full payment of debts is limited by their inability to secure those rights against domination by these directors. The grievance that requires remediation in the phoenix context is the unpaid debts of the insolvent company. Some unsecured creditors will have additional concerns, such employees who lose their jobs as well as their entitlements. While some unpaid creditors may have a

\textsuperscript{31} Access to Justice Advisory Committee, above n 28, 7-8.
\textsuperscript{32} Ibid.
\textsuperscript{33} Parker, above n 28, 30.
\textsuperscript{34} See eg Vicki Waye and Vince Morabito,’ The Dawning of the Age of the Litigation Entrepreneur’ (2009) 28(3) \textit{Civil Justice Quarterly} 389.
\textsuperscript{35} Access to Justice Advisory Committee, above n 28, 8.
\textsuperscript{36} Ibid.
\textsuperscript{38} Parker, above n 28, 32-8.
\textsuperscript{39} Australian Attorney General’s Department, above n 29, 1.
\textsuperscript{40} Productivity Commission, above n 1, 3.
\textsuperscript{41} Parker, above n 28, 31.
natural desire to see directors who have engaged in phoenix activity punished for their wrongdoing and disqualified from acting as directors in the future, the most important outcome from the unpaid creditors’ perspective is to receive full payment of all monies owing to them.

B Practical Difficulties

1 Dealing with Insolvent Companies

Liquidation as a collective recovery regime theoretically makes good sense. It takes away the benefits of being the first creditor to claim, and therefore avoids costly and duplicative monitoring of the company’s solvency. It also achieves administrative efficiencies at the time of liquidation. The collective scheme is intended to result in an increased aggregate pool of assets. In other words, the total amount received by creditors as a group is as much or more than the sum of what they would have received if they had enforced the claims individually. In exchange for receiving these benefits, creditors ‘agree’ to stay their rights to take individual action. Many creditors are assumed to be risk averse, and to prefer to receive a more certain, lesser sum than a less certain, greater one.

However, the stay on legal action by individuals means that their own ‘access to justice’ is in the hands of a third party whose motivations necessarily are not the same as their own. Therefore, while liquidation might decrease the overall costs to the company of allocating its remaining assets across all claimants, it deprives those who are active in their own protection of the benefit of their own vigilance. Arguably it discourages creditors from monitoring companies in a manner that might discourage illegal phoenix activity. For example, if superannuation funds were able to enforce claims, outside of the liquidation regime, against failed companies for unremitted payments, those funds could be motivated to pay closer attention to employers with poor payment histories. This added scrutiny may dissuade company controllers from engaging in illegal phoenix activity, believing their actions to be ‘under the radar’.

Thus there is no scope for private settlement of a debt claim by an unsecured creditor directly against the company. Indeed, the Corporations Act has measures to counteract this because private settlement robs the company of money that could be spread across all creditors with similar claims. The liquidator may take action against the creditor to recover the money through the recovery of unfair preferences. Having disgorged this, the creditor takes their place with the other creditors to receive a pro rata distribution once the company’s affairs are wound up. That said, preference recovery actions are costly and success is by no means assured. In deciding to pursue recovery, the liquidator must make an assessment of the likelihood of success and balance that against the legal costs of proceeding. By definition, insolvent companies in liquidation do not have sufficient funds to pay the company’s debts. The liquidator is therefore spending money on preference recovery litigation that might otherwise be distributed to creditors as part payment of the amounts owed to them. In addition, the liquidator is under no legal obligation to pursue preferences where there is no

44 Jackson, above n 43, 864.
46 Jackson, above n 43, 862-3.
47 Corporations Act 2001 (Cth) s 588FA
certainty that their own fees will be met.48 This advantages those creditors who have the economic power to demand private settlement from the company, at the expense of those small creditors who cannot.

The Assetless Administration Fund came into operation in 2007 and is designed to overcome the issue of liquidators of assetless companies lacking funds to chase errant directors. However, its main focus is on investigations where director banning proceedings may be appropriate49 or where court proceedings for serious misconduct pursuant to the Corporations Act may be warranted.50 Since 2012, the AAF has allowed application for funding for the recovery of assets may now be made where there is suspected fraudulent or unlawful phoenix activity,51 but the liquidator must have obtained sufficient evidence to support the banning or enforcement action.52 The scheme therefore relies on a liquidator making substantial inquiries paid for out of their own pocket prior to being funded, and also being willing to prepare the detailed paperwork of the funding application. As a result, it is likely that possible instances of illegal phoenix activity are not investigated and recoveries for the benefit of its victims not made.

2 The Lack of a Phoenix Offence
One of the most difficult aspects of being a victim of illegal phoenix activity is that there is no specific offence or legislative provision that gives an avenue for legal recovery for the phoenix activity. Even the special recovery provisions available to creditor/regulators such as the ATO and state revenue offices discussed below, do not relate expressly to illegal phoenix activity. This is more than a technical deficiency. It goes to the heart of access to justice because it highlights the fact that it is legal for a company to close its doors with its debts unpaid and for its controllers to incorporate a new company to carry on the same business. As a result, neither the creditor nor ASIC can readily distinguish from externally visible factors whether this is a legal ‘business rescue’ or an ‘illegal phoenix’. The creditors’ ability to obtain access to justice under these provisions is entirely dependent upon either the liquidator or ASIC choosing to initiate proceedings. The issues that face liquidators in preference recovery actions outlined above also apply to actions for breach of duty. As a consequence, these types of liquidator actions are infrequently run and therefore are not able to provide adequate access to justice for creditors. ASIC’s role in enforcing these provisions is discussed below. While the issues outlined in this section apply to all unsecured creditors some types of creditors face additional difficulties.

3 Issues for specific creditors
(a) Issues for the ATO and SROs
While the ATO and SROs may rarely be the object of widespread sympathy as creditors, it is important to remember that if these taxes are not collected, the government will need to find that revenue somewhere else. This may result in higher rates or different types of taxation that law-abiding taxpayers are required to pay. In addition, companies that do not pay their taxes are able to out-compete those that do, leading to the difficult choice for some of either breaking the law or going out of business. Haines notes the significance of economic

48 Corporations Act 2001 (Cth) s 545.
49 See ASIC, ‘Insolvency practitioners complaints statistics’ (March 2011). Between July 2006 and December 2011, 332 directors were banned and 193 of those were as a result of funding from the AAF.
51 Ibid, 15 [RG 109.28].
52 ibid, 19-20 [RG 109.37]–[RG 109.39].
pressures on business and comments that ‘[i]f the profit levels are so tight that … compliance is not compatible with staying in business, then … non-compliance is the likely result.’  

The director penalty regime, expressly designed to allow the recovery of PAYG(W) and unremitted superannuation from directors, is not without its difficulties for the ATO. The Commissioner must issue a director penalty notice and wait 21 days before commencing recovery action. If liabilities have been reported, directors can avoid personal liability by promptly placing the company into external administration. The director penalty is only not remitted as a result of placing the company into administration or beginning to wind it up where three months has lapsed after the due day for the company liability and the liability remains both unreported and unpaid.  

(b) Issues for Employees
While the priority enjoyed by employees in a liquidation was noted above, ‘the first bite of nothing is still nothing.’  

The Fair Entitlements Guarantee (FEG) scheme compensates the employees of insolvent employers for the non-payment of their wages and other entitlements. This scheme and its predecessors have cost taxpayers approximately $1.5 billion since 2000. It is subject to caps and limitations, and is only available to those employees whose companies are in liquidation. Independent contractors are excluded from its coverage. Liquidators processing the FEG claims face the sorts of issues which occur frequently in the ‘access to justice’ context: language difficulties, poorly educated workers, those with tenuous status in the country such as recent migrants or visa holders, and those with irregular work arrangements.

Moreover, FEG does not cover unremitted superannuation. The protection of superannuation poses special problems for employees. Because payments are made by the employer directly to the fund, employees are often unaware of their non-remittance. The ATO is the enforcement agency in relation to unremitted super via the Superannuation Guarantee Charge but there is no reporting mechanism by which funds can alert the ATO to non-receipt. Again, parties such as young people, casual workers, foreign visa holders and those from non-English speaking backgrounds are especially vulnerable as they may not be aware of their proper super entitlements.

(c) Issues for Unsecured Creditors
Creditor self-protection plays a major part in the traditional theoretical justification for shareholder limited liability. Ex ante, creditors are expected to seek security, either from the debtor company or its controllers, or else charge more for goods and services to compensate for the occasional loss. However, small trade creditors are unlikely to have the bargaining

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54 Taxation Administration Act 1953 (Cth) s 269-30(2).
58 Superannuation Guarantee (Administration) Act 1992
power to seek either of these, and the preferential status of secured creditors such as banks exacerbates the situation for these unsecured creditors. These means of self-protection are also unavailable to a customer losing a deposit to a tradesman engaging in illegal phoenix activity. Moreover, customers are unlikely to have previous experience with the situation and will not know what rights they have. Even discovering that the tradesman’s company is in liquidation is difficult. Unsecured trade creditors are likely to have more knowledge but may lack the resources to fund a liquidator to take action against the company’s controllers even where the illegal phoenix activity is evident.

One way of improving the position of unsecured creditors, and thereby allowing them to obtain a remedy for their grievances, is to increase the pool of funds that are available to the liquidator. This could be achieved by a successful enforcement action initiated against the company directors personally by either the liquidator or by ASIC. We have examined the difficulties faced by liquidators when they seek to initiate these types of actions and have noted that these types of proceedings do not occur frequently. The following section considers the role of the public regulator in initiating enforcement action for the purpose of improving the ability of creditors to obtain access to justice.

C The Role of the Public Regulator

There are a number of enforcement mechanisms at ASIC’s disposal if it suspects that a company has been phoenixed. Not all of those actions will result in compensation being obtained that will flow to unsecured creditors. Those actions that do not allow ASIC to seek compensation are director disqualifications, either via a court application or an internal administrative procedure, and the winding up of dormant companies. In contrast, ASIC can seek compensation when one of the civil penalty provisions has been contravened. The civil penalty provisions that may be breached in a phoenix context are the statutory directors’ duties that require directors to act for a proper purpose and not make improper use of their position, and the duty to prevent insolvent trading; which may be contravened if the company’s transfer of an asset below market value prior to liquidation constitutes an uncommercial transaction.

The fact that ASIC has the power to issue an enforcement action that may assist creditors to access justice raises interesting normative questions about the appropriate role of a public regulator is in this context. Should a public regulator use the limited resources at its disposal to take action on behalf of creditors who have suffered a loss as a result of a contravention of the law that it is tasked to regulate? If this is deemed to be an appropriate use of the regulator’s resources, should such an action be prioritised over other enforcement actions?

In order to explore these questions it is useful to consider the ways in which regulatory scholars have defined regulation. Black defines regulation as ‘the sustained and focused

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61 Corporations Act 2001 s 206D; s206E.
62 Corporations Act 2001 s 206C.
63 Corporations Act 2001 s 489EA.
64 Corporations Act 2001 s 181 and 182.
65 Corporations Act 2001 s 588G(1A).
attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes'.

According to Baldwin, Cave and Lodge the primary aim of regulation is to reduce behavior that is harmful to others by either preventing an individual from engaging in it or by deterring others from doing so. The OCED defines regulation as that which 'serves clearly identified policy goals', and Haines says the role of regulation is to 'attempt to bring about a clearly defined end'.

The behavior that requires modification in the phoenix context is the misuse of the corporate form by the transfer of assets at undervalue. Therefore, from a normative perspective regulation of phoenix activity should deliver a sustained and focused attempt to alter the behavior of persons who would otherwise engage in this type of activity with the clearly defined policy goal, or clearly defined end, of reducing its future incidence and the losses to unsecured creditors that would be caused by it. If this is the normative role of regulation in the phoenix context what then should be the role of the publicly funded regulator? Arguably its role should be to utilise the enforcement mechanisms it has at its disposal in strategic ways designed to reduce this type of illegal behavior by encouraging greater compliance with the relevant directors' duties that may be breached in the phoenix context. The ASIC Act provides that ASIC must strive to among other things ‘take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it’. Responsive regulation theory has much to say about how this goal should be achieved. It requires regulators to choose from the available enforcement mechanisms the one that is most likely to encourage future compliance. It requires public regulators to adopt a forward looking approach, focused on changing future behavior, rather than on achieving redress for victims of past contraventions.

If we accept that the primary role of a publicly funded regulator when exercising its enforcement function is to utilise the enforcement mechanisms at its disposal for the purpose of increasing the regulated community’s commitment to compliance, does that leave any room for the seeking of compensation for victims? In the context of illegal phoenix activity one could argue that ASIC’s resources should not be expended for the purpose of securing compensation which will ultimately flow to creditors because this could distract the regulator from its primary function, delay the resolution of public enforcement actions and place additional financial burdens on the regulator.

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70 Haines, above n 53, 8.
71 Welsh, above n 66.
72 ASIC Act 2001 (Cth) s 1(2)(g).
73 Responsive regulation was developed and expanded by John Braithwaite and Ian Ayres. See, eg, Ian Ayres and John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (Oxford University Press, 1992); see also Brent Fisse and John Braithwaite, Corporations, Crime and Accountability (Cambridge University Press, 1993); Fiona Haines, Corporate Regulation: Beyond ‘Punish or Persuade’ (Clarendon Press, 1997) 218; John Braithwaite, ‘The Essence of Responsive Regulation’ (2011) 44 University of British Columbia Law Review 475, 479 n 9.
These potential for these problems to arise was recognized by the UK Department for Business Innovation and Skills in its 2012 consultation paper entitled ‘Private Actions in Competition Law: A Consultation on Options for Reform’ (‘BIS’). Although focused on private enforcement in the competition context, the consultation paper includes a useful discussion of the role of a public regulator, the UK Office of Fair Trading (‘OFT’), in facilitating redress. The BIS noted that ‘alongside a strong private actions regime, the Government recognises that there are some situations where it may be appropriate for the public enforcement body to consider mechanisms for redress, as part of its administrative settlement of cases.’ However, the Department also recognised that a compensatory role should not detract from the regulators’ role in detecting, investigating and sanctioning activity that contravenes the laws or regulations.

Whilst recognising that any involvement in delivering redress would involve some resource implications, the Government would not wish the OFT to become so involved in the business of quantifying the degree of loss suffered by consumers or business that this led to an impairment in carrying out its other functions. To divert resources away from or delay enforcement activities in order to help facilitate compensation could cause a reduction in deterrence and therefore an increase in anticompetitive behaviour.

The UK Government agreed with this approach and in its response to the BIS report stated that ‘[a]ny work therefore that the OFT will undertake on redress schemes would be in addition to this primary competition work, and should not be a substantial burden on resource.’

Nonetheless, it may be possible for the regulator to achieve its primary objective of securing increased compliance by seeking and obtaining compensation orders. Scholars who support a compensatory role for public regulators point to synergies in the regulatory outcomes that can flow from both public and private enforcement. Public enforcement serves the public interest in that it is traditionally associated with notions of punishment and deterrence. Deterrence theory relies on the economic premise that members of the regulated community will internalise the cost of non-compliance and if this cost can be set at a sufficiently high level, would-be non-compliers will comply with the law. Private enforcement, on the other hand, serves private interests and is traditionally associated with notions of corrective justice. However, it has been argued that a private enforcement action can also serve a deterrent function. For example Ezrachi and Ioannidou believe that private damages claims can provide a public interest outcome because they ‘not only serve as a channel for corrective justice, but also supplement the deterrent function of public enforcement.’ Hodges argues that from an economic perspective:

> the costs of non-compliance can equally well be produced by fines imposed by public authorities (whether enforcement authorities or courts) as by damages and costs imposed by private actions. Both

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75 United Kingdom Department for Business Innovation and Skills Private Actions in Competition Law: A Consultation on Options for Reform (April 2012), at [6.26].
76 Ibid, [6.27].
77 Ibid, [6.29]. The BIS was discussing this in the context of the role of the UK Office of Fair Trading.
78 Ibid, [6.31].
mechanisms involve the same medium, money and pressure is therefore both equal and transferable between the two mechanisms.81

If both traditional public enforcement mechanisms and private damages claims can result in deterrence, then it should also be true that a compensation order imposed following a public enforcement action should produce a deterrent effect. From a deterrence perspective it should make little difference whether a public enforcement action results in a fine or a compensation order, assuming that the quantum of the orders is the same. Equally there should be little difference from a regulator’s point of view between an order that requires a defendant to pay an amount as compensation and an order that requires a defendant to pay an amount as a fine. As Hodges argues ‘[t]he concept that a public entity may deliver private remedies is merely the converse of the thesis that private bodies may deliver public enforcement.’82

Ezrachi and Ioannidou have argued for ‘public compensation’83 in the context of the regulation of competition in the EU. Under these regimes competition regulators could impose a compensation award in favor of the injured parties in addition to a fine, following an investigation.84 While this goes beyond the powers currently available to ASIC the authors’ reasoning is applicable to that regulator’s role in seeking compensation via a court order. Ezrachi and Ioannidou argued that:

Public compensation constitutes a hybrid approach to enforcement since it achieves a primarily private enforcement goal, that is compensation, through public enforcement mechanisms. At the same time though, it furthers deterrence as the primary goal of public enforcement. Thus, ‘Public Compensation’ transcends the dichotomy between public and private enforcement and the deterrence and compensation goals of competition law enforcement (citations omitted).85

For those that view the primary role of a public regulator in terms of being solely focused on securing future compliance, obtaining compensation for victims is an appropriate use of resources, provided that it is done in furtherance of that role and does not detract from it. Some go further and argue that a regulator’s role encompasses the seeking of compensation for victims of regulatory contraventions, regardless of whether or not it contributes to increased deterrence. In 2006 Richard Macrory undertook a review of regulatory sanctions for the UK Government.86 Macrory argued that six principles should be adhered to by those who design sanctioning regimes for non-compliance. Regulatory sanctions should:

1. Aim to change the behaviour of the offender;
2. Aim to eliminate any financial gain or benefit from non-compliance;
3. Be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction;
4. Be proportionate to the nature of the offence and the harm caused;
5. Aim to restore the harm caused by regulatory non-compliance, where appropriate; and
6. Aim to deter future non-compliance.87

81 Hodges, above n 74, 196.
82 Hodges above n 74, 228.
83 Ezrachi, above n 80, 537.
84 Ibid, 537.
85 Ibid, 538.
87 Ibid, 10
Arguably principles one, three, four and six resonate with the traditional view of the role of a public regulator. However, principles two and five envisage a wider role for the public regulator which could include seeking compensation for victims of the contravention, independent of any need to send a deterrent message.

Given the difficulties faced by creditors in gaining access to justice that are outlined above, there is a clear need for the public regulator to seek compensation from the directors’ personally when they have breached duties in the phoenix context. If obtained, that compensation will be paid to the company which will increase the pool of funds that is available for distribution to creditors. Arguable this task fits both within the narrow view of the appropriate role of the regulator that is supported by regulatory theory and within the wider view proposed by the Macrory Report. The Australian parliament was clearly of the view that seeking redress for victims was an appropriate role for a public regulator when it granted ASIC the power to seek compensation orders under the civil penalty regime. Other Australian regulators have also been given similar powers. 88 Given that ASIC has this power to assist creditors of phoenixed companies and that such a power is arguably appropriate we now turn to a consideration of the way in which ASIC has used these provisions in order to determine whether in reality they have provided a mechanism whereby unsecured creditors have been able to achieve access to justice.

Seeking compensation is clearly not ASIC’s priority when it brings civil penalty proceedings. The last compensation order sought was in 2006. 89 In total, ASIC has only sought a compensation order in only 11 of the 38 civil penalty applications it has brought, and it has never been the sole order sought. 90 In the only case concerning illegal phoenix activity, compensation was not sought by the regulator. 92 So while ASIC’s powers to seek compensation of behalf of creditors could theoretically increase their access to justice, in reality this has not occurred.

VI CONCLUSION

Not all of the creditor victims of illegal phoenix activity face the same difficulties in seeking access to justice. Revenue authorities enjoy special rights because of their status as protectors of the government revenue. Nonetheless, all are confronted by the limited liability that is enjoyed by shareholders and exploited in the phoenix context, the rules regulating the distribution of funds in insolvency, the limitations faced by liquidators, the lack of a specific phoenix offence and a lack of standing on the part of creditors to enforce breaches of the directors’ duties that occur in the insolvency context. Their common grievance is the non-payment of debts in full by an insolvent company from which assets have been stripped at undervalue. One way of improving access to justice in this context is to increase the pool of

88 Australian Competition and Consumer Commission: Competition and Consumer Act 2010 (Cth) ss 87(1A)(b), 87(1B). The UK Financial Services Authority: Financial Services and Markets Act 2000 UK ss 382 and 383. See also Hodges, above n 74.
89 This ultimately unsuccessful application was issued against Fortescue Metals Group and Andrew Forrest: Forrest v ASIC (2012) 291 ALR 399.
92 Ibid.
funds available for distribution to unsecured creditors by seeking compensation from directors personally.

Both the liquidator and ASIC can issue proceedings seeking compensation against directors that have phoenixed their companies. However practical difficulties faced by liquidators mean that these types of actions are issued infrequently. Assisting creditors to access justice by seeking compensation orders against directors who have phoenixed their companies can be an appropriate use of ASIC’s resources, especially where doing so does not detract from its traditional enforcement role. The need for the regulator to do this is particularly acute in the phoenix context because of the limited rights that creditors have to act on their own behalf. However, the data suggests that ASIC does not see the obtaining of compensation orders as its priority. It is to be hoped that in future, ASIC considers the issues raised above relating to access to justice when it contemplates actions against directors engaged in illegal phoenix activity.