This paper was presented at the Corporate Law Teachers Association Annual Conference, Griffith University, 5–7 February 2017. A revised version of the paper will be published in the *Company and Securities Law Journal* in 2017.

ILLEGAL PHOENIX ACTIVITY: IS A 'PHOENIX PROHIBITION' THE SOLUTION?

Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh*

Abstract

Phoenix activity is not inherently illegal but illegal phoenix activity is generally understood to be those actions, undertaken in the phoenix context, that breach laws because they involve wrongdoing. Because illegal phoenix activity continues to cause significant harm to creditors of companies, employees and revenue authorities, it is not surprising that many continue to suggest a specific phoenix prohibition as the answer. To date, however, this has not been achieved. This paper considers attempts to define or proscribe illegal phoenix activity before examining the existing laws, including directors' duties, that already prohibit this behaviour. Working on the belief that illegal phoenix activity continues because these 'generalist' laws are under-enforced in the phoenix context, we suggest a new approach. Rather than devising a new prohibition that describes the circumstances of illegal phoenix activity, the enforcement of the existing directors' duties should be bolstered by removing the financial benefits of phoenix activity and by substantially increasing the relevant penalties. Our suggested amendments – if taken up by the government – send a valuable signal to wrongdoers that their behaviour will be severely punished, and to ASIC that this is an area in which enforcement can produce significant benefits.

I INTRODUCTION

This paper is part of a larger project that investigates phoenix activity. In the first stage of our research we profiled the characteristics of both legal and illegal phoenix activity to assist regulators including the Australian Securities and Investments Commission (ASIC) and the Australian Taxations Office (ATO) in formulating education, detection, and enforcement strategies.[1] In the second stage we

* Helen Anderson is Professor, Melbourne Law School, University of Melbourne; Jasper Hedges is Research Fellow, Melbourne Law School, University of Melbourne; Ian Ramsay is the Harold Ford Professor of Commercial Law, Melbourne Law School, University of Melbourne; and Michelle Welsh is Professor and Head of Department, Department of Business Law and Taxation, Monash Business School, Monash University. The research reported in this article was funded by the Australian Research Council: DP140102277, 'Phoenix Activity: Regulating Fraudulent Use of the Corporate Form'.

investigated the incidence, cost and enforcement of laws that deal with phoenix activity.[2] In the third and final stage of our research we have been investigating possible solutions to the problem of what we have termed 'harmful' phoenix activity.[3]

Phoenix activity is not inherently illegal, and there is no express phoenix prohibition. Actions undertaken in the phoenix context are only illegal when they involve wrongdoing that constitutes a breach of another law. Given that phoenix activity has been a longstanding issue, it is not surprising that there have been many solutions proposed. One of these is the creation of a specific legislative prohibition to deal with deliberate phoenixing with the intention to deprive creditors. This paper documents past attempts which date back to 1994 with the most recent attempt being proposed in 2016. In our opinion, attempts to proscribe phoenix activity involving wrongdoing are unlikely to succeed. A broad prohibition is likely to capture legitimate business rescues while a narrow one is easily sidestepped.

Our research has concluded that the disruption and deterrence of this harmful activity will involve many separate measures.[4] Together, they should create an environment that we believe will discourage all but the most determined fraudsters. These measures attack phoenix activity's invisibility, its profitability and its effortlessness. Regulators already have a broad range of legislative provisions available to them to deal with illegal phoenix activity, most notably the directors' duties provisions of the *Corporations Act 2001* (Cth). In our opinion, a key issue in dealing with this activity is under-enforcement but rather than creating a specific prohibition for ASIC to enforce, we believe a more effective approach is to amend the consequences of a breach of the directors' duties. This would involve new compensation provisions to remove the profitability of phoenix activity, whether from the hands of the wrongdoer or their new company, and an increase to the relevant civil and criminal penalties. This achieves the targeted message of deterrence that a 'phoenix prohibition' is supposed to achieve. It also signals to ASIC that it has substantial tools to use against phoenix wrongdoers, and that it should use them.

The structure of the paper is as follows. Part II describes phoenix activity, outlines attempts to create a phoenix prohibition and discusses the continuing interest in a phoenix prohibition. Part III examines a number of existing legislative provisions which can apply to illegal phoenix activity and notes that these provisions have rarely been used to deal with illegal phoenix activity. In Part IV, we ask whether a phoenix prohibition is the solution to this apparent under-enforcement and we set out our alternative approach.

---

1 Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, *Defining and Profiling Phoenix Activity*, Centre for Corporate Law and Securities Regulation, December, 2014.

2 Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, *Quantifying Phoenix Activity: Incidence, Cost*, *Enforcement*, Centre for Corporate Law and Securities Regulation, November, 2015.

3 Helen Anderson, Ian Ramsay, Michelle Welsh and Jasper Hedges, *Phoenix Activity: Problems and Recommendations*, Centre for Corporate Law and Securities Regulation, 2017 (forthcoming). Our first report separated phoenix activity into five categories – two legal and three illegal, with the second legal category being 'problematic' phoenix activity. Harmful phoenix activity comprises the three illegal categories of phoenix activity and the problematic category.

4 Ibid.

II BACKGROUND AND PREVIOUS ATTEMPTS TO CREATE A PHOENIX PROHIBITION

A *What is phoenix activity?*

The concept of 'phoenix activity' broadly centres on the idea of a company failing and a second company, often newly incorporated, arising from its ashes with essentially the same controllers and business. Phoenix activity can be legal as well as illegal. Legal phoenix activity covers situations where the previous controllers start another similar business, using a new company when their earlier company fails, in order to rescue its business. Illegal phoenix activity involves similar activities, but the intention is to exploit the corporate form to the detriment of unsecured creditors, including employees and tax authorities.

In a typical phoenix activity scenario, a company in financial difficulties, 'Oldco', is placed into liquidation or voluntary administration, or is simply left dormant and eventually deregistered. Prior to this occurring, Oldco's assets may be transferred either to a newly incorporated entity, 'Newco', or to an existing entity, such as a related company in a corporate group. As noted below, phoenixing can also occur without the transfer of assets.

Phoenix activity can be entirely legal and even desirable, especially if the worth of the failed company's assets is maintained and the employees keep their jobs and entitlements. We describe this behaviour as 'legal phoenix activity, or business rescue'.[5] However, the repeated resurrection of a business can become problematic even in the absence of an improper intention where the returns to creditors and benefits to employees are minimal. The behaviour only becomes illegal where the intention of the company's controllers is to use the company's failure as a device to avoid paying Oldco's creditors, who may include the ATO and the company's employees. While it is appropriate for those involved in problematic phoenix activity to be subject to limitations on their ability to manage companies in the future,[6] this paper concentrates on those who have deliberately engaged in phoenix activity to avoid payment of corporate debts.

Phoenix activity involving the use of successor companies – one after the other – was described as 'basic' phoenix activity in Treasury's 2009 proposals paper entitled *Action Against Fraudulent Phoenix Activity*.[7] In addition, Treasury defined phoenix arrangements within corporate groups as 'sophisticated' phoenix activity.[8] Typically, under Treasury's sophisticated form, one entity with few or no assets within a corporate group incurs substantial liabilities by way of wages, superannuation contributions, or tax liabilities, and then is deliberately liquidated to avoid paying these debts. Employees may be transferred to a sibling entity in the group to continue their employment, and may or may not be paid their entitlements.

5 Anderson et al, *Defining and Profiling Phoenix Activity*, above n 1.

6 *Corporations Act* s 206D, s 206F.

7 Treasury (Cth), *Action against Fraudulent Phoenix Activity,* Treasury, Australian Government, 2009, (2009 Phoenix Proposals Paper), 2.

8 Ibid 2.

The cost of illegal phoenix activity is difficult to quantify.[9] However, recent estimates suggest that the cost is significant. For example, in 2009 Treasury estimated the cost of phoenix activity to be between $1 billion and $2.4 billion a year. This was estimated to include approximately $600 million per year in lost tax revenue.[10] In 2012, a report prepared for the Fair Work Ombudsman (FWO) estimated the total cost to employees, business and government revenue at between $1.8 billion and $3.2 billion annually.[11]

B *Previous attempts to define and prohibit wrongdoing during phoenix activity*

There are two dimensions to creating a phoenix prohibition – describing or defining what phoenix activity is, and then designing a provision that prohibits and punishes it appropriately. Both dimensions require the drafter to delineate the objectionable form while not inhibiting legitimate business rescues. This part of the paper outlines the various attempts that have been made by law reform bodies, various parliamentary committees and a Royal Commission over the course of the last few decades to either define wrongdoing during phoenix activity or design legislative prohibitions. It also discusses some of the difficulties in trying to capture a complex phenomenon like phoenix activity in a single definition or prohibition.

1 *1994 Victorian Law Reform Committee Report*

The earliest report dealing exclusively with illegal phoenix activity in Australia was that of the Victorian Law Reform Committee (VLRC) in 1994.[12] It did not seek explicitly to define the activity, but rather described it as follows:

> The problem is the 'phoenix' company. A limited liability company fails, unable to pay its debts to creditors, employees and the State. At the same time, or soon afterwards, the same business arises from the ashes with the same directors, under the guise of a new limited liability company, but disclaiming any responsibility for the debts of the previous company.[13]

The VLRC made a number of suggestions for reforms to tackle phoenix activity,[14] including legislation to 'place restrictions on the use of business names similar to those of a failed corporation by persons associated with the failed corporation'.[15] This recommendation was based on legislation existing in the United Kingdom, noted further below.

2 *1996 ASC Phoenix Activity Research Paper*

---

[9] Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost*, *Enforcement*, above n 2.

[10] 2009 Phoenix Proposals Paper, 5.

[11] PricewaterhouseCoopers and Fair Work Ombudsman, *Phoenix Activity - Sizing the Problem and Matching Solutions* (June 2012), (2012 PWC FWO Phoenix Activity report) [1.2].

[12] Parliament of Victoria Law Reform Committee, *Curbing the Phoenix Company - First Report on the Law Relating to Directors and Managers of Insolvent Corporations,* Report No 83 (1994).

[13] Ibid 1 [1.1].

[14] These mainly focused on dealing with disqualified directors, and included better resourcing of the regulator, better computer programs to track disqualified directors and a unique identifier number: Parliament of Victoria Law Reform Committee, above n 12, xxi–xxv.

[15] Ibid, recommendation 11.

In 1996, the Australian Securities Commission, the predecessor of ASIC, produced a research paper into phoenix activity and insolvent trading. It reviewed the relevant literature, conducted a telephone survey and in-depth interviews with community leaders and ASC staff.[16] It clarified and amended the VLRC definition discussed above, pointing out several additional elements or indicators of illegal phoenixing:

- Any incorporated form can be involved, not just limited liability companies;
- Phoenixing can include the purposeful wasting of corporate assets prior to insolvency, as well as the transfer of those assets to a new entity;
- In some instances, some creditors are paid but others are not (depending on their likelihood of taking debt recovery action);
- Timeframes are difficult to specify;
- The assets may be transferred to another entity, which may or may not be incorporated, and which may or may not be engaged in the same business; and
- The same directors or managers may not always be involved in the new business because their families or other related parties may assume those roles.[17]

According to the ASC Research Paper, a definition of phoenix activity must include 'an element of intent which separates out those who make Phoenix activities a career from those who accidentally fall foul of the … definition through ignorance of the law and its requirements'. The ASC Research Paper also specified that not all cases of phoenix activity involve the transfer of assets or the transfer of substantially the same business to the new entity. As such, the paper noted that for a definition to be workable it must take into account the *benefit* derived from any transfer of assets, or else the benefit derived from purposefully wasting the assets, rather than simply stating that the same business is transferred to the new operation.[18]

The ASC Phoenix Activity Research Paper defined phoenix activities as:

> […] those where an incorporated entity either:
> - fails and is unable to pay its debts and/or;
> - acts in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts; and
> - within 12 months another business commences which may use some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.[19]

Two difficulties are immediately apparent. The first is that Oldco may have no assets from its inception. The second is the use of the word 'commences'. In many instances of sophisticated phoenix activity, the company to which the business activities of the old company are transferred is already in existence at the time of the demise of the first.

16 Australian Securities Commission, 'Project One: Phoenix Activity and Insolvent Trading Public Version' (ASC Research Paper 95/01, May 1996) 11.
17 Ibid 35-38.
18 Ibid 39-40.
19 Ibid 39.

The ASC Research Paper identified three types of phoenix operators:

- 'Innocent' operators who lack the awareness that transferring assets from the failed business to the new company may constitute a breach of the law;
- 'Occupational hazard' operators who own a business in an industry where failure is common. Here only a small number of assets may be transferred to the new entity;
- 'Careerist' offenders who deliberately structure their businesses so as to engage in phoenix activity and avoid detection.[20]

Despite, or perhaps because of, the exhaustive consideration of phoenix activity conducted by the National Intelligence and Analytical Service on behalf of the ASC, the report made no recommendation for a legislated prohibition. It concluded that '… phoenix activity is one area that can only be improved in the long term by changes to the Corporations Law which make it easier to define and prosecute offenders.' It then deferred to the Attorney General's Department Simplification Task Force Stage Three proposal, 'Officers and Related Party Transactions: Proposals for Simplification'.[21] Relevant to the present discussion, the Simplification Task Force document only made recommendations relating to disqualification for company failures where there had been mismanagement, and did not expressly address phoenix activity.

3 *2003 Cole Royal Commission Report*

The Cole Royal Commission was established 'to inquire into certain matters relating to the building and construction industry.'[22] An entire chapter of its extensive Final Report was devoted to phoenix companies.[23] It did not seek to define what they were, instead adopting the ASC definition of phoenix activity without criticism. Its approach was to describe in detail the circumstances in which phoenix activity may occur, identify its victims, and provide case studies. Like the VLRC report noted above, the Cole Royal Commission Report made a series of recommendations.[24] It did not attempt to proscribe phoenix activity although it did call for 'an increase in the maximum penalties provided in the *Corporations Act 2001* (Cth) for offences that may be associated with fraudulent phoenix company activity'.[25] We discuss the issue of increased penalties in Part 4 below.

4 *2004 Parliamentary Joint Committee Report*

---

[20] Ibid 44-47.

[21] Attorney-General's Department, Corporations Law Simplification Program, Task Force October, 1995 at http://www.takeovers.gov.au/content/Resources/corporations_law_simplification_program/downloads/Officers_and_Related_Party_Transactions.pdf.

[22] Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report* (2003) (Cole Royal Commission report) vol 2, 3.

[23] Ibid, vol 8, ch 12.

[24] These included a review of minimum penalties, better information sharing between regulators, the capacity for disqualification after one corporate failure in appropriate circumstances, and adequate resourcing for ASIC. Ibid 164-166.

[25] Cole Royal Commission report, above n 22, recommendation 108, vol 8, ch 12, 166.

In 2004, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) released a report entitled 'Corporate Insolvency Laws: A Stocktake'. The report examined a broad range of issues, one of which was phoenix activity.[26] Chapter 8 of the Stocktake Report, devoted to phoenix activity, noted that it was 'almost impossible to define fraudulent phoenix company activity with any precision',[27] although it referred to the approach of the Cole Royal Commission without criticism. It did not address the issue of an express proscription of phoenix activity.

5 *2009 Phoenix Proposals Paper*

The Australian Government Treasury released a paper at the end of 2009 entitled 'Action against Fraudulent Phoenix Activity Proposals Paper'.[28] The Paper called for public comments and feedback, in particular on the need for legislative amendments to address illegal phoenix activity and on the relative merits of a variety of proposals.[29] While the main focus of the Paper's recommendations was phoenix activity as it related to non-payment of taxation liabilities, it also made several recommendations for reform of the *Corporations Act 2001* (Cth). Like earlier reports, it considered changes to the disqualification regime but it also revisited the idea proposed by the VLRC of a restriction on the use of similar names.[30]

To implement this recommendation, in late 2011 the Federal Government released an exposure draft of the Corporations Amendment (Similar Names) Bill 2012.[31] It was part of the then Labor Government's fulfilment of a 2010 pre-election commitment[32] and the Parliamentary Secretary to the Treasurer, the Hon David Bradbury, claimed:

> 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.

---

26 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004). Its terms of reference included '(h) whether special provision should be made regarding the use of phoenix companies': Ibid vii.

27 Ibid 131 [8.2].

28 2009 Phoenix Proposals Paper, above n 7.

29 Ibid 22.

30 One of the items in the 'summary of options to address fraudulent phoenix activity' was to 'Restrict the use of a similar name or trading style by successor company' by making 'directors personally liable for the debts of a liquidated company in circumstances where a 'new' company adopts the same or similar name as its previous incarnation (see p vii).

31 At the same time as releasing the exposure draft of the Corporations Amendment (Similar Names) Bill 2012, the Government released an exposure draft of the Corporations Amendment (Phoenixing and Other Measures) Bill 2012. The latter Bill was passed by the Senate on 9 May 2012 and received Royal Assent on 26 May 2012. For a detailed discussion of this legislation, see Helen Anderson, 'The Proposed Deterrence of Phoenix Activity: An Opportunity Lost?' (2012) 34 *Sydney Law Review* 411.

32 Australian Labor Party, 'Protecting Workers' Entitlements Package' (25 July 2010), http://parlinfo.aph.gov.au/parlInfo/download/library/partypol/NQGX6/upload_binary/nqgx60.pdf;fileType=application%2Fpdf#search=%22securing%20super%22

> 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.

The United Kingdom[33] and New Zealand[34] have legislation dealing with similar names. The Corporations Amendment (Similar Names) Bill 2012 provided that a director of a failed company could be jointly and individually liable for the debts of a company that has a similar name to a pre-liquidation name of the failed company.[35] Certain time limits were specified.[36] The court could make exemptions where the person had acted honestly, and having regard to all the circumstances of the case, the person ought fairly to be exempt,[37] with certain matters specified to which the court must have regard, including 'the extent to which, and the circumstances in which, any assets of the failed company have become assets of the debtor company'.[38] The failed company's liquidator was also to be empowered to make a similar determination.[39] An exemption was also granted if the failed company has paid its debts in full.[40]

The Bill had a number of limitations.[41] It would not have captured phoenix behaviour where a different name was used for the new company. It also would not have captured the incorporation of a new entity with a similar name to the failed company where a related party of a director of the failed company, for example a spouse, son or daughter, was appointed director instead. The Bill also did not impose liability on directors for the debts of the failed company, but only for the debts of the new entity,[42] and only if that new company was not carrying on business.[43] This seems anomalous as the phoenix activity has caused harm to the creditors of the failed company rather than the new one.

The Bill was never introduced into Parliament and the concept of a Similar Names Bill has not been raised again.

6 *2012 PricewaterhouseCoopers Report for the Fair Work Ombudsman*

Whereas Treasury's 2009 phoenix proposals paper considered phoenix activity from the tax perspective, the 2012 PWC report considered it from the labour law perspective.[44] After examining previous definitions of phoenix activity and phoenix indicators, it noted six possible bases for a definition: corporate form; liability; signs or indicators; names; criminal conduct; or multiple factors.[45] It settled upon:

---

33 *Insolvency Act 1986* (UK) s 216.
34 *Companies Act 1993* (NZ) s 386A.
35 Corporations Amendment (Similar Names) Bill 2012, s 596AJ(1).
36 Corporations Amendment (Similar Names) Bill 2012, s 596AJ(1)(b) and (d).
37 Corporations Amendment (Similar Names) Bill 2012, s 596AK(3).
38 Corporations Amendment (Similar Names) Bill 2012, s 596AK(4)(b).
39 Corporations Amendment (Similar Names) Bill 2012, s 596AL.
40 Corporations Amendment (Similar Names) Bill 2012, s 596AN.
41 See further Anderson, 'Proposed Deterrence of Phoenix Activity', above n 31.
42 Corporations Amendment (Similar Names) Bill 2012, s 596AJ(1).
43 Corporations Amendment (Similar Names) Bill 2012, s 596AM(1)(b).
44 2012 PWC FWO Phoenix Activity report, above n 11.
45 Ibid 11-12.

Phoenix activity is the deliberate and systematic liquidation of a corporate trading entity which occurs with the illegal or fraudulent intention to:

- avoid tax and other liabilities, such as employee entitlements, and
- continue the operation and profit taking of the business through another trading entity.

The PWC report immediately added:

Phoenix activity can also involve, though does not always involve:

- the continuation of the operation of the business under the same name
- the directorship of the new company being held by a close associate of the director of the former company
- employees of the former company continuing to be employed by the new company, and/or
- the liquidation of one company within a group of companies.

The avoidance of liabilities can include contractual or statutory obligations and civil or criminal proceedings.

However, it shied away from devising a general phoenix prohibition and its recommendations for reform were limited to those enhancing the powers of the Fair Work Ombudsman.[46]

7 *Fair Work Amendment (Protecting Australian Workers) Bill 2016*

Shortly prior to the commencement of the caretaker period before the 2016 federal election, the Opposition (the Australian Labor Party) released a draft bill to amend the Fair Work Act that included a provision to remedy the effect of phoenix activity on unpaid employees. The timing of the Bill is possibly an indication of its purpose as political strategy rather than a considered piece of legislative drafting. Nonetheless, it is interesting to examine the proposed provision to highlight the difficulties in attempting to legislate descriptively in relation to phoenix activity.[47]

545A Orders requiring executive officers of phoenix companies to pay amounts owed by failed companies

(1) The Federal Court, the Federal Circuit Court or an eligible State or Territory court must order that a person (the ***liable person***) pay an amount to, or on behalf of, another person (the ***affected person***) if the court is satisfied that:

---

46 In brief, these were to grant the FWO a garnishee power over former phoenix company directors; to amend the Fair Work Act 2009 to include a civil remedy provision to prohibit an employer entering into a transaction with the intention of preventing its employees from recovering their employee entitlements; and to grant the FWO standing under the Corporations Act to sue on behalf of employees to recover entitlements where the employer has sought to deliberately prevent employees from recovering entitlements.

47 See further Helen Anderson 'Labor's Policy To Deal With Phoenix Activity Affecting Employees' (2016) 34 *Company and Securities Law Journal* 316.

(a) a company registered under the *Corporations Act 2001* (the ***failed company***) contravened subsection 44(1), section 45, 50, 280, 293 or 305 or subsection 323(1) or 357(1); and

(b) the contravention involved a failure by the failed company to pay an amount (the ***underpayment***) that it was required to pay to, or on behalf of, the affected person under this Act or a fair work instrument; and

(c) the liable person was an executive officer of the failed company at the time of the contravention; and

(d) after the contravention, the failed company was wound up; and

(e) an unsecured debt or claim was proved in the winding up; and

(f) the relevant date (within the meaning of the *Corporations Act 2001*) in relation to the winding up is on or after the commencement of this subsection; and

(g) the liable person becomes an executive officer of a company (the ***phoenix company***) that is registered under the *Corporations Act 2001* within 12 months after the failed company was wound up; and

(h) the phoenix company uses any of the assets that were used by the failed company before it was wound up; and

(i) some or all of the underpayment remains unpaid (whether by the failed company, the phoenix company or any other person) to the person or persons to whom it should have been paid; and

(j) the liable person should not be exempt from this section in relation to the contravention.

Clearly this proposed provision only targets the recovery of employee entitlements and is therefore not attempting to be a general proscription against wrongdoing during phoenix activity. However, despite its length, it has a number of shortcomings. First, it fails to define the phoenix company in any terms other than as the employer of the executive officer[48] and the user of the failed company's assets. As such, it captures most legitimate examples of phoenix activity that are beneficial business rescues. Secondly, there are temporal issues – the contravention must precede the winding up (and whether that is the commencement or conclusion of the winding up is unclear); and the liable officer must become an officer of the phoenix company within 12 months *after* the winding up. These sorts of temporal requirements become a roadmap for avoidance. To sidestep this provision, the officer could simply create

48 The term 'executive officer' is defined in s 545A(2) of the draft section as follows: '(2) An executive officer of a company registered under the Corporations Act 2001 is a person, by whatever name called and whether or not a director of the company, who is concerned in, or takes part in, the management of the company.'

and be employed by the phoenix company before the winding up of the failed company.

C *Continuing interest in a phoenix prohibition*

As is evident from the proposals discussed in Part II.B, there is a long history of interest in the creation of a legislative provision that specifically prohibits illegal phoenix activity. ASIC itself seems to have endorsed such a provision as recently as July 2015 in its supplementary submission to the Productivity Inquiry into business set up, transfer and closure.[49] ASIC notes that s 596AB of the *Corporations Act*, which prohibits people from entering into agreements or transactions with the intention of denying employees their entitlements and which is discussed below, has had limited effectiveness.[50] It also noted that bringing actions under ss 180-184 or s 588G of the Act for breaches of directors' duties can be costly, although it did not elaborate on this point. As a result, ASIC suggested that the Commission consider the merit of introducing a provision similar to s 121 of the *Bankruptcy Act 1966* (Cth) that makes:

> 'it an offence to transfer property from Company A (where Company A is subsequently wound up or abandoned) to Company B, if the main purpose of the transfer was to prevent, hinder or delay the process of the transferred property from becoming available for division amongst Company A's creditors.'

ASIC went on to explain that:

> 'Such a transaction should be both void against a liquidator (so that a liquidator can claw back the assets) and an offence. Consideration could also be given to whether such an offence should give rise to a right in creditors, liquidators and ASIC to sue for compensation against:
> (a) directors who engage in the prescribed conduct; and
> (b) those who are knowingly involved in that conduct under s 79 of the Corporations Act for the loss caused by the conduct (e.g. lawyers, insolvency practitioners and accountants).

This suggestion is clearly a 'phoenix prohibition', although it would not capture so-called 'sophisticated' phoenix arrangements within corporate groups that do not involve transfers of assets.[51] In its Productivity Commission submission, ASIC argued that such a reform would 'provide a clear indication of the seriousness with which the government and its agencies regard illegal phoenix conduct,' suggesting

---

49 Australian Securities and Investments Commission, *Productivity Inquiry into business set up, transfer and closure: ASIC's supplementary submission* (July 2015), Parliament of Australia, (ASIC PC second submission), 16-17.

50 Ibid [60]. The Senate Economics References Committee ('SERC'), in its inquiry into insolvency in the Australian construction industry, has stopped short of recommending a comprehensive phoenix prohibition, but has recommended that s 596AB of the *Corporations Act* be amended to: remove the requirement to prove subjective intention in relation to phoenixing offences; introduce a parallel civil penalty contravention in similar terms; and extend the application of the section to all forms of external administration, not merely liquidation. Australian Government, Senate Economics References Committee, 'I just want to be paid' Insolvency in the Australian construction industry', December 2015, ('2015 SERC Construction Insolvency Report'), recommendation 19.

51 2009 Phoenix Proposals Paper, above n 7, [1.1.2].

that a phoenix prohibition along these lines would be in part a signalling mechanism.[52]

However, ASIC's position on the creation of a phoenix prohibition does not appear to be entirely consistent. ASIC Commissioner Greg Tanzer, when asked whether the creation of a specific law dealing with illegal phoenix activity would make it easier for ASIC to act and act quickly in an ABC interview in June 2015, answered:

> '…our view is that we've got the tools under the directors' duties provisions where the activity is illegal and that's really where directors who are acting deliberately and dishonestly to dud creditors.
>
> And we're very active in that field through our directors disqualification program and indeed our own prosecution program assisting liquidators.'[53]

Commissioner Tanzer, in an article published in July 2014, noted that ASIC, at the request of Treasury, 'provided Treasury with potential law reform options that would make illegal phoenix activity a specific offence and strengthen ASIC's power to prosecute illegal phoenix activity.'[54] To date, Treasury has not endorsed a specific legislative provision that prohibits phoenix activity.

A phoenix prohibition appears to be favoured by some of those dealing with phoenix activity on a practical basis. A number of the people interviewed as part of our research advocated the enactment of a legislative provision that specifically prohibits illegal phoenix activity, although one interviewee conceded that distinguishing legitimate business rescues from deliberately improper behaviour would be difficult. We also conducted surveys of members of the Australian Restructuring, Insolvency and Turnaround Association ('ARITA')[55] and the Australian Institute of Credit Management ('AICM')[56] on illegal phoenix activity and related issues.

One ARITA respondent commented that '[t]he Corporations Act ought to deal specifically with phoenix activity rather than relying on a combination of the breach of duty (180-183) sections.' Similarly, another respondent said we need 'specific legislation/rules applicable for dealing between related parties concerning acquisition or disposal of assets before the transaction is completed; directors' duties are too broad to rely on to establish breach of duty remedies.' One respondent alluded to the potential educational value of creating a phoenix prohibition, noting that we 'need some similar legislation to NZ defining what a phoenix is; many directors do not

---

52 ASIC PC second submission, above n 49, [68].

53 Simon Lauder, Interview with Greg Tanzer, ASIC Commissioner (Radio Interview, 12 June 2015) <http://www.abc.net.au/pm/content/2015/s4254172.htm>.

54 Greg Tanzer, 'Stopping the Phoenix's Flight' (1 July 2014) *Company Director Magazine*.

55 ARITA is a professional association with over 2,000 members that represents those who specialise in the fields of restructuring, insolvency and turnaround, including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring: Australian Restructuring, Insolvency & Turnaround Association, *About Us* <http://www.arita.com.au/about-us>.

56 AICM is Australia's leading professional association for commercial and consumer credit management professionals, with over 2,300 members responsible for maximising the cash flow and minimising the bad debt risk of more than 1,300 Australian companies, including 34 of the ASX100. Australian Institute of Credit Management, *About AICM* <http://aicm.com.au/about-aicm/>.

understand the concept of phoenix activity.' The ARITA respondents also showed a particular concern that those who facilitate illegal phoenix activity through pre-insolvency advice should also be subject to such a prohibition. One respondent suggested that we 'introduce a criminal sanction for advisers aiding directors in phoenix activity,' while another recommended 'penalties (via law reform) for phoenix facilitators and advisors.'

These comments were echoed by some of the AICM respondents. For example, one respondent said 'we ought to create one definition of illegal phoenix activity, legislate it, and ASIC should prosecute where there are breaches.' Another respondent commented that 'legislation should be in place to cover aspects of financial transacting' involving illegal phoenix activity.

PART III – ENFORCEMENT OF EXISTING LEGISLATION WHICH APPLIES TO PHOENIX ACTIVITY

Despite the attempts discussed in the previous section to create an illegal phoenix activity prohibition, it is important to note that there are a number of existing legislative provisions that potentially deal with illegal phoenix activity. For example, there are numerous provisions that proscribe fraud, breaches of directors' duties and destruction of company books and records, to name just a few of the unlawful behaviours that can occur when the business of Oldco is transferred to Newco for the improper purpose of avoiding debts owed to Oldco's creditors.

Before considering the enforcement of existing provisions that prohibit the wrongdoing that occurs during phoenix activity, we must note – and set aside – the laws that can be used in the phoenix context that do not involve deliberate wrongdoing. These include the director penalty provisions contained in the *Taxation Administration Act* and the disqualification provisions of the *Corporations Act* that allow ASIC, or the Court, to disqualify a director involved in two or more failed companies.[57] Each of these require some involvement on the part of the director – a failure to liquidate the company promptly or a finding that disqualification is justified[58] – but they would not be described as a 'prohibition' against the kinds of behaviours that occur during phoenix activity.[59]

There is an extensive list of laws that target the improper conduct of directors and officers involved in phoenix activity.[60] This Part now considers the main provisions that effectively prohibit phoenix activity where it is done deliberately, asking what, if anything, these sections lack that makes creating some further phoenix prohibition appealing.

---

[57] *Taxation Administration Act 1953* (Cth), sch 1, div 269; *Corporations Act* ss 206D and 206F respectively.

[58] *Taxation Administration Act 1953* (Cth), sch 1, s 269-5; *Corporations Act* ss 206D(1)(b)(ii) and 206F(1)(c) respectively.

[59] We also note here the accessory liability provisions. For example, s 550 of the *Fair Work Act* imposes liability on those who are knowingly involved in civil remedy breaches of the Act, such as the non-payment by the employer company of employee entitlements. These sorts of provisions stray closer towards wrongdoing but we do not consider them further in this paper.

[60] See further Anderson et al, *Defining and Profiling Phoenix Activity*, above n 1.

The most prominent of these are the directors' duties under Chapter 2D of the Corporations Act 2001 (Cth). They are the duty of care and diligence;[61] the duties to exercise powers and discharge duties in good faith in the best interests of the corporation and for a proper purpose;[62] the duties to not use position or information improperly to gain an advantage for oneself or someone else, or to cause detriment to the company;[63] and the duty to prevent insolvent trading by the company.[64] For example, the misuse of position to make a personal gain or to benefit another entity at the time of insolvency in phoenix circumstances is clearly within the scope of s 182.

The directors' duties can be enforced by way of either civil or criminal sanctions, with the exception of the duty of care and diligence which does not attract criminal liability. Civil penalty proceedings for breach of directors' duties can be brought by ASIC seeking pecuniary penalties of up to $200,000 per contravention, disqualification orders and compensation orders.[65] The corporation can issue proceedings seeking compensation.[66] The availability of civil penalties for breaches of directors' duties is intended to facilitate enforcement by overcoming the difficulties that are perceived to be associated with traditional criminal regimes for corporate crimes because of their requisite evidentiary requirements and burden of proof.

Criminal sanctions can be sought for breaches of directors' duties where the director or officer has breached the duty and additional *mens rea* elements are present, which include various combinations of dishonesty, recklessness and intention.[67] Criminal prosecutions are carried out by the Commonwealth Director of Public Prosecutions ('CDPP'). The criminal sanctions include custodial sentences of up to five years and fines of up to $360,000 per offence.[68] There are also a range of criminal sanctions available under the *Crimes Act 1914* (Cth), such as reparation orders, community service orders and good behaviour bonds.[69]

However, despite the applicability of directors' duties to illegal phoenix activity and the availability of civil sanctions that are intended to facilitate higher rates of enforcement, the estimates of the cost of phoenix activity to the economy, as noted in Part II.A, suggest that such activity is still prevalent. In turn, this raises a question about the efficacy of enforcement actions taken against illegal phoenix operators, who are not being deterred from continuing their unlawful activities. While it is not possible to precisely identify how much phoenix activity involves illegality or even how much enforcement takes place against illegal phoenix activity because of a lack of available data,[70] we believe illegal phoenix activity is under-enforced. For example, since civil penalties were introduced for breaches of directors' duties in 1993, there has only been one civil penalty application brought by ASIC for breach of

---

61 *Corporations Act* s 180.
62 *Corporations Act* s 181.
63 *Corporations Act* s 182 and s 183.
64 *Corporations Act* s 588G(2).
65 *Corporations Act* ss 1317G, 206C, 1317H and 1317J(1).
66 *Corporations Act* s 1317J(2).
67 *Corporations Act* ss 184, 588G(3).
68 *Corporations Act* sch 3.
69 See, eg, *Crimes Act 1914* (Cth) s 21B, pt IB div 5 sub-div D.
70 Anderson et al, *Quantifying Phoenix Activity: Incidence, Cost*, *Enforcement*, above n 2.

directors' duties in the context of phoenix activity[71] and the only orders imposed were disqualification orders,[72] despite the availability of both pecuniary penalties and compensation orders. To get a sense of perspective on the enforcement of insolvency related wrongdoing, in 2015-2016, external administrators reported that they suspected 174 criminal breaches of the directors' duties and 1,125 civil breaches of the s 182 duty.[73]

The directors' duties are not the only under-utilised laws in the phoenix context. From 2000, uncommercial transactions became actionable as insolvent trading.[74] An undervalued transfer of assets – very typical during phoenix activity – is an uncommercial transaction.[75] By deeming the transaction to be the incurring of a debt, the 2000 amendment enables ASIC to issue civil penalty proceedings alleging a contravention of the insolvent trading provisions, against directors. However, we could not locate any cases of ASIC using this mechanism to punish phoenix operators between 2004 and 2014. Another provision passed in 2000, and noted above in Part II.C is s 596AB, which provides that:

> '[a] person must not enter into a relevant agreement or a transaction with the intention of, or with intentions that include the intention of:
>
> > (a) preventing the recovery of the entitlements of employees of a company; or
> >
> > (b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.'

Section 596AB has never been used, despite the comments that accompanied its introduction.[76]

While insolvent trading has a civil penalty avenue for enforcement, s 596AB can only be enforced by ASIC as a criminal provision.[77] As anti-phoenix prohibitions, criminal offences may be more difficult to enforce than civil provisions due to the need to prove *mens rea* elements and the 'beyond reasonable doubt' standard of proof. While failing to disclose property of the company, improper disposition or fraudulent

71 *ASIC v Somerville & Ors* (No 2) [2009] NSWSC 998.

72 Ibid.

73 ASIC, *Report 507, Insolvency statistics: External administrators' reports* (July 2015 to June 2016), December 2016, Tables 30 and 31 respectively. They also reported 150 suspected breaches of the criminal insolvent trading provision and 5,736 civil penalty breaches of insolvent trading. Ibid.

74 *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth) inserted s 588G(1A) into the *Corporations Act*. See Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000 (Cth) para. [10]: 'The inclusion of uncommercial transactions in section 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'.

75 *Corporations Act* s 588FB.

76 Explanatory Memorandum of the Corporations Law Amendment (Employee Entitlements) Bill 2000 (Cth), 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'. At [18]. In 2015-2016 alone, external administrators reported 9 suspected breaches of this provision: ASIC report 507, above n 73, Table 30.

77 Note that liquidators can seek to recover the employee entitlements from the directors in the absence of a criminal conviction: *Corporations Act* s 596AC(2).

concealment of property[78] seem particularly applicable to phoenix activity, it is difficult to prove intention or recklessness in the phoenix context because its external manifestations are likely to be similar whether it is a legitimate ‘business rescue’ or an illegitimate avoidance of Oldco’s liabilities. Even an ‘undervalued’ transaction is hard to discern without a detailed investigation because it can be difficult to know whether the price obtained for Oldco’s assets was the best available.

There is also a range of fraud-related tax laws that would be relevant to the phoenix context,[79] including s 5 of the *Crimes (Taxation Offences) Act 1980* (Cth) which was introduced to deal with ‘bottom of the harbour’ schemes in the 1980’s.[80] It carries a potential 10 year jail term and a $180,000 fine. In its submission to Treasury in response to the 2009 *Proposal Paper*, accountants and business advisory firm Pitcher Partners argued that that Act is an ‘ideal “vehicle” … for taking action to address fraudulent phoenix activity’[81] yet it appears not to have been used against phoenix activity.

Strict liability summary offences are easier to prove and ASIC frequently conducts summary prosecutions for failing to provide information to liquidators and failing to assist them as required under ss 475 and 530A of the Corporations Act.[82] However,

---

78 *Corporations Act* Part 5.8, including ss 590, 596. Orders may be made against those convicted of fraud under s 598.

79 *Criminal Code Act 1995* (Cth): Dishonestly obtaining Commonwealth property (s 134.1(1)); Obtaining financial advantage by deception (s 134.2(1)); Dishonestly causing a loss to the Commonwealth (s 135.4(3)); *Taxation Administration Act*: Failure to comply with requirements under taxation law (s 8C); Failure to answer questions when attending before the Commissioner or another person pursuant to a taxation law (s 8D); Making false or misleading statements to a taxation officer (s 8K) or recklessly making false or misleading statements (s 8N); Incorrectly keeping records (s 8L) or recklessly incorrectly keeping records (s8Q); Incorrectly keeping records with intention of deceiving or misleading (s 8T); Falsifying or concealing identity with intention of deceiving or misleading (s 8U); Directors and officers are liable for taxation offences committed by the company (s 8Y).

80 *Crimes (Taxation Offences) Act 1980* s 5(1): Where a person enters into an arrangement or transaction with the intention of securing, either generally or for a limited period, that a company or trustee (whether or not a party to the arrangement or transaction) will be unable, or will be likely to be unable, having regard to other debts of the company or trustee, to pay income tax payable by the company or trustee, the person is guilty of an offence. See further Lidia Xynas, ‘Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance’ (2011) 20(1) *Revenue Law Journal* 2.

81 Pitcher Partners, ‘Submission into Proposals Paper Action against Fraudulent Phoenix Activity’ (8 January 2010) <http://archive.treasury.gov.au/documents/1892/PDF/Pitcher_Partners.PDF> 5.

82 Based on our analysis of data contained in ASIC’s summary prosecution reports, enforcement reports and annual reports, along with the CDPP’s annual reports, it is estimated that ASIC carried out approximately 6,742 summary prosecutions in the 18-year period from 1 July 1997 to 30 June 2015. A study published by the Australian Institute of Criminology in February 2013 found that 80% of successful summary prosecutions by ASIC were for breaches of ss 475 and 530A of the *Corporations Act*, while 96% of all prosecutions resulted in fines, at an average of $917.85 per fine: see Australian Government, Australian Institute of Criminology (AIC), Convictions for Summary Insolvency Offences Committed by Directors (Report No 30, February 2013) 4–6. The AIC study found that s 1314 of the *Corporations Act* was the third most frequently successfully prosecuted provision, mostly relating to continuing or ongoing breaches of s 475: at 4. Offences prosecuted by ASIC under provisions other than ss 475, 530A and 1314 included ‘failure to notify a change of address or directors, false or misleading statements, acting as a director while suspended, failure to keep minutes, failure to maintain registers and other failure to assist-type insolvency offences where the external administrator was a controller or an administrator rather than a liquidator’: at 4.

the maximum penalty for a failure to provide the liquidator with books and records is $9,000. It makes sense for someone anxious to shed company debts – perhaps worth hundreds of thousands of dollars– to destroy the books and records of the company, start again with a new debt-free company, and tolerate a $9,000 fine. The reality of phoenix enforcement is that ASIC expects liquidators to bear the principal burden of bringing actions. However, phoenix liquidations usually involve companies with little or no assets. Liquidators are not obliged to do any work other than the minimum reporting requirements[83] unless they are paid.[84] Assetless administration funding[85] requires liquidators to establish a case that there has been wrongdoing, [86] which is extremely difficult in the absence of books and records. As a result, disposing of the company's books and records protects deliberate phoenixers from accountability under the law, either via the civil penalty regime or criminal prosecution.

This considerable list of provisions available against illegal phoenix activity might indicate that no new laws are needed. However, two factors suggest otherwise. One is the continued interest in deterring phoenix activity, outlined above, because of its ongoing cost to the economy and government revenues. New laws could deter potential wrongdoers. The other is the apparent under-utilisation of the existing 'generalist' measures. New laws would send a message to ASIC that enforcement in the area of illegal phoenix activity is important and will achieve significant and beneficial outcomes.

IV – IS A 'PHOENIX PROHIBITION' THE SOLUTION?

A *The Case for (and against) a Phoenix Prohibition*

If we conclude that new laws are needed, the question then becomes what those laws should be. Part II.B above showed the difficulties of descriptive phoenix prohibitions. Yet the notion of a specific phoenix prohibition is appealing as a deterrent to deal with those prepared to risk accusations of breach of directors' duties in the murky boundary between legitimate business rescue and illegal phoenix activity. For example, in the Somerville penalty hearing,[87] Windeyer AJ noted:

> [Mr Somerville] continued to give that advice even after he knew that ASIC was conducting the investigations which brought about these proceedings. He agreed that he had been told by Mr Krejci, one of the accountants involved in liquidating some of the companies, that Mr Krejci considered the transactions to be uncommercial but he thought that was incorrect. He said to Mr Krejci that no one had challenged the transactions and "until the Court proves otherwise I will continue to promote them".[88]

A phoenix prohibition can send an educative message to company controllers and their advisors and has the potential to increase their commitment to compliance.

---

83 *Corporations Act* s 533(1).
84 *Corporations Act* s 545 (1) and (3).
85 ASIC Regulatory Guide 109: Assetless Administration Fund: Funding Criteria and Guidelines (November 2012).
86 Ibid 19 and 25.
87 *ASIC v Somerville (No 2)* [2009] NSWSC 998 (24 September 2009).
88 Ibid [30].

There are three broad factors – normative, social, and calculated[89] – that motivate regulated persons to comply with the law. A person who is normatively motivated to comply is driven by their 'internalized values or moral reasoning'.[90] Such a person's perception of the immorality of certain behavior is influenced by the level of disdain with which that behavior is viewed by society.[91] Prohibiting certain behaviour is one way of increasing the perception that it is immoral and undesirable, and of increasing the perceived value, legitimacy and importance of *not* engaging in the specific behavior. Introducing a phoenix prohibition has the potential to send such a message.

A person who is motivated to comply by social factors has a desire to be approved of and respected by their peers.[92] This includes avoiding any negative publicity and reputational damage that may flow from being found to have engaged in undesirable behavior,[93] such as breaching a phoenix prohibition. Persons motivated by calculated factors are concerned with the costs of compliance, the likelihood that their wrongdoing will be detected and that enforcement action will be commenced, and the severity of the penalties that may be imposed.[94]

However, having considered the efforts to define or proscribe phoenix activity made over the past two decades and the various arguments for a 'phoenix prohibition', we remain unconvinced that such a prohibition would add value to the existing legal regime. Our view is that it would be difficult, if not impossible, to draft a legislative provision that is more specific than the existing directors' duties that adequately covers the various complex manifestations of phoenix activity. Those seeking to design a 'descriptive' provision, such as the 2016 attempt by the ALP to enable recovery of employee entitlements lost to phoenix activity, must grapple with the many and varied dimensions of the conduct. As Part II.A noted, phoenix activity sometimes involves a transfer of assets but not always; sometimes it involves the same people becoming directors of Newco but on other occasions, family members or associates take those roles; sometimes the Newco business uses a similar name but not always.

A proposed provision dealing only with the externally discernible facts risks becoming hugely complex, full of loopholes or so general that it is accused of stifling legitimate business rescues. What must be penalised is the wrongdoing, not the circumstances in which it occurs. As Part III observed, the directors' duties neatly capture directors' misbehaviour during phoenix activity, regardless of whether undervalued assets are transferred to Newco or whether the phoenix activity occurs within a group involving dispensable assetless subsidiaries. Because wrongdoing during phoenix activity *necessarily* entails a breach of directors' duties, it is unnecessary to design an entire new legislative scheme. Rather than adding to the complexity of a patchwork of laws that already govern illegal phoenix activity, our

89 Soren C Winter and Peter J May, 'Motivation for Compliance with Environmental Regulations' (2001) *Journal of Policy Analysis and Management* 675, 676.
90 Yuval Feldman and Doron Teichman 'Are All Legal Probabilities Created Equal?' (2009) 84 *New York University Law Review* 980, 993.
91 Tom R Tyler, 'Why People Obey the Law' (1990) Yale University Press, New Hampshire, 25-6.
92 Winter & May, above n 89, 678.
93 Ibid.
94 Ibid 676.

proposal is to strengthen the compensation and profit-stripping remedies, along with the punitive penalties, that are available for breaches of directors' duties. We believe that this proposal would serve the dual function of incentivising ASIC and private litigants to use the existing directors' duties more frequently, as they stand to gain more from enforcement action, and deterring illegal phoenix operators, as they stand to lose more from engaging in phoenix activity.

B *The Sanctions Solution: An Alternative to a 'Phoenix Prohibition'*

While directors' duties already adequately prohibit wrongdoing during phoenix activity, there are a number of deficiencies in respect of the sanctions that can be sought for breaches of directors' duties that are particularly problematic in this context. Deterrence theory relies on the economic premise that members of the regulated community will internalise the cost of non-compliance and that this cost should be set at a sufficiently high level so that would-be non-compliers will comply with the law.[95] The introduction of a significant penalty, coupled with the loss of the often considerable financial gain from illegal phoenix, could increase the perceived cost of non-compliance with directors' duties, making compliance more attractive for those who are motivated by calculated factors.

However, in order for this to be achieved there must be an effective enforcement mechanism attached to the directors' duties. According to Winter and May the cost-benefit 'calculus is affected by likelihood of detection—and by the speed, certainty, and size of the sanction imposed. As such, the enforcement regime is, theoretically at least, an important component of calculations of expected utility.'[96] In other words, not only must the sanctions for a breach of directors' duties in the phoenix context be enhanced, but ASIC must increase the frequency of its enforcement actions. An amendment of the law by Parliament sends valuable messages to both miscreant and enforcer.

1 *Expand the reach of compensation orders under s 1317H*

Section 1317H(1) allows the court to order a person in contravention of a civil penalty provision to compensate the company for damage resulting from the contravention. Section 1317H(2) provides that '[i]n determining the damage suffered by the corporation or scheme for the purposes of making a compensation order, include profits made *by any person* resulting from the contravention or the offence.'[97] This sub-section has been interpreted by the courts to be a standalone 'account of profits' mechanism. That is, it is not necessary to prove *any* loss on the part of the corporation or scheme that has 'suffered the damage' in order to obtain a 'compensation' order under s 1317H; the 'damage' can be *entirely* comprised of profits.[98] So-called 'compensation' orders under s 1317H can therefore be compensation orders, account of profits orders, or a combination of both.

---

95 Christine Parker and Vibeke Lehmann Nielsen, 'What Do Australian Businesses Really Think of the ACCC, and Does It Matter?' (2007) 35(2) *Federal Law Review*, 187, 192.

96 Winter and Mahy, above n 89, 676.

97 Emphasis added.

98 *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296, 431–4 [620]–[631]; *V-Flow Pty Ltd v Holyoake Industries (Vic) Pty Limited* (2013) 296 ALR 418, 429 [54]; R. P. Austin and I. M. Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (Online edition, LexisNexis

Section 1317H(2) would allow a court to order the director in breach to compensate Oldco for the profits made by Newco from an undervalued transaction. But what it does not do is allow the court to order Newco – an entity not in breach of any law – to hand over its gains. Potentially, Newco could be deprived of its benefit through the use of either accessory liability under s 79 of the *Corporations Act* or through the 'knowing receipt' first limb of *Barnes v Addy*.[99] There are also a variety of state-based property law provisions that can require the return of property transferred as fraudulent conveyances.[100] However, expanding the reach of s 1317H would both facilitate enforcement and provide the signalling benefits discussed in Part IV. Courts, and those tempted by illegal phoenix activity, would have a clear indication from Parliament that the beneficiary of the breach of duty should be stripped of the gains it has made. This explicit statement overcomes the need for courts to 'piece together' the same outcome which is implicit in s 79 and s 1317H.

We propose that s 1317H be amended as follows, to allow for orders to be made against Newco where Newco is 'involved in the contravention' (within the meaning of s 79 of the *Corporations Act*) or 'controlled' (within the meaning of s 50AA of the *Corporations Act*) by the director in breach.

Compensation orders—corporation/scheme civil penalty provisions

Compensation for damage suffered

(1) A Court may order a person, including a corporation (the ***liable person***) to compensate another person, including a corporation, or a registered scheme, for damage suffered by the other person or scheme if:

(a) the liable person has contravened a corporation/scheme civil penalty provision in relation to the other person or scheme; and

(b) the damage resulted from the contravention.

The order must specify the amount of compensation, which may include, or be solely comprised of, profits pursuant to s 1317H(2).

Butterworths, 2016), [3.400.12]. See also *Lifeplan Australian Friendly Society Ltd v Woff* [2016] FCA 248, [424], [440]; *Brentwood Village Limited (in liq) v Terrigal Grosvenor Lodge Pty Limited (No 4)* [2016] FCA 1359, [54]; *Agricultural Land Management Ltd v Jackson (No 2)* [2014] WASC 102, [434]; *Cornerstone Property & Development Pty Ltd v Suellen Properties Pty Ltd & Anor* [2014] QSC 265, [144]–[145].

99 *Barnes v Addy* (1874) LR 9 Ch App 244; *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89; R. P. Austin and I. M. Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (Online edition, LexisNexis Butterworths, 2016), [16.180]–[16.300].

100 See, eg, *Property Law Act 1958* (Vic) s 172; *Conveyancing Act 1919* (NSW) s 37A; *Property Law Act 1974* (Qld) s 228; *Property Law Act 1969* (WA) s 89; *Law of Property Act 1936* (SA) s 86; *Conveyancing and Law of Property Act 1884* (Tas) s 40; *Law of Property Act 2000* (NT) s 208; *Civil Law (Property) Act 2006* (ACT) s 239.

Note: An order may be made under this subsection whether or not a declaration of contravention has been made under section 1317E.

(1A) A Court may order a person, including a corporation (the ***involved beneficiary person***) to compensate another person, including a corporation, or a registered scheme, for damage suffered by the other person or scheme if:

(a) the liable person has contravened a corporation/scheme civil penalty provision in relation to the other person or scheme; and

(b) the involved beneficiary person was involved in the contravention within the meaning of s 79 of this Act; and

(c) the damage resulted from the contravention.

The order must specify the amount of compensation, which may include, or be solely comprised of, profits pursuant to s 1317H(2).

Note: An order may be made under this subsection whether or not a declaration of contravention has been made under section 1317E.

(1B) A Court may order a person, including a corporation (the ***controlled beneficiary person***) to compensate another person, including a corporation, or a registered scheme, for damage suffered by the other person or scheme if:

(a) the liable person has contravened a corporation/scheme civil penalty provision in relation to the other person or scheme; and

(b) the damage resulted from the contravention; and

(c) the liable person controls the controlled beneficiary person within the meaning of s 50AA of this Act; and

(d) the controlled beneficiary person possesses property as a result of the contravention; or

(e) the controlled beneficiary person has made profits within the meaning of s 1317H(2) as a result of the contravention.

The order must specify the amount of compensation, which may include, or be solely comprised of, profits pursuant to s 1317H(2). The amount of compensation must not exceed the combined value of the property that the controlled beneficiary person possesses pursuant to s 1317H(1B)(d) and the profits that the controlled beneficiary person has made pursuant to s 1317H(2).

Note: An order may be made under this subsection whether or not a declaration of contravention has been made under section 1317E.

Damage includes profits

(2) In determining the damage suffered by a person or scheme for the purposes of making a compensation order, include profits made by any person resulting from the contravention. A compensation order may be solely comprised of such profits.

Damage to scheme includes diminution of value of scheme property

(3) In determining the damage suffered by a registered scheme for the purposes of making a compensation order, include any diminution in the value of the property of the scheme.

(4) If the responsible entity for a registered scheme is ordered to compensate the scheme, the responsible entity must transfer the amount of the compensation to the scheme property. If anyone else is ordered to compensate the scheme, the responsible entity may recover the compensation on behalf of the scheme.

Recovery of damage

(5) A compensation order may be enforced as if it were a judgment of the Court.

The expanded s 1317H ensures that those engaging in illegal phoenix activity are deprived of the benefits of their behaviour where those benefits are held by Newco, and victims are compensated to the maximum extent possible. This is a critical amendment to directors' duties enforcement, which currently does not provide any clear pathway for recovering the benefits of illegal phoenix activity except from the wrongdoers themselves. As noted above, s 588FB does allow liquidators to recover benefits resulting from uncommercial transactions, but its availability depends upon the transaction occurring during the company's insolvency, which significantly reduces its effectiveness.[101] Likewise, ASIC's ability to bring civil penalty or criminal insolvent trading action in relation to uncommercial transactions via s 588G(1A) is also limited by the requirement of insolvency.[102] Attaching the recovery mechanism to directors' duties rather than uncommercial transactions avoids the requirement of actual insolvency at the time of the transaction. At the same time, the directors' duties provisions provide an important limitation on the reach of the recovery mechanism, ensuring that enforcement action is only taken in cases of wrongdoing and not genuine business rescues.

A possible alternative to an expanded s 1317H would be a separate disgorgement power for ASIC. This would allow ASIC to remove the gains from Newco but without

[101] *Corporations Act* s 588FE(3), with 'insolvent transaction' defined by s 588FC.
[102] *Corporations Act* s 588G(1)(b).

the money necessarily being paid to Oldco's creditors. Instead, the money would be paid into consolidated revenue. ASIC has been vocal in seeking to undermine financial incentives that encourage wrongdoing. For example, in its submission to the Senate Economics References Committee's white collar crime inquiry, ASIC stated:

> 'Disgorgement' is the removal of financial benefit … that arises from wrongdoing, or the act of paying these monies, on demand or by legal compulsion. For example, any profit made by wrongdoing is 'disgorged' from those involved in the wrongdoing in addition to any penalties that are imposed.
>
> Disgorgement is a vehicle for preventing unjust enrichment. This means that disgorgement orders can offer significant deterrent value by reducing the likelihood that wrongdoers can consider penalties to be merely a business cost.[103]

ASIC noted in that submission that while it could request the Australian Federal Police or the Commonwealth Director of Public Prosecutions to bring confiscation action under the *Proceeds of Crime Act 2002* (Cth), it did not have the power to seek disgorgement in civil penalty proceedings.[104] ASIC has noted many overseas jurisdictions where this sort of remedy is available to government securities regulators.[105] It stated:

> While the precise mechanism of disgorgement varies between jurisdictions, the fundamental feature of disgorgement in all jurisdictions is that the illegal profits gained or losses avoided are removed from the wrongdoer. This is achieved by:
>
> > (a) having legislated maximum penalties that are a multiple of the financial benefit obtained from the wrongdoing (New Zealand, Singapore and the United States);
> >
> > (b) taking into account the financial benefit obtained from the wrongdoing when determining the quantum of penalty that should be imposed (Hong Kong and the United Kingdom); or
> >
> > (c) having a disgorgement power that is distinct from the ability to impose non-criminal penalties (Canada, Hong Kong, the United Kingdom and the United States).
>
> In contrast, maximum non-criminal penalties for corporate wrongdoing in Australia are set at fixed amounts. As a result, it may not be possible for ASIC or courts to remove the financial benefit obtained from corporate wrongdoing in non-criminal settings even if the maximum penalty is imposed.

Where victims of illegal phoenix activity have suffered a loss, we prefer the court to compensate them through the award of compensation or an account of profits, rather than a disgorgement order in favour of ASIC or consolidated revenue. In these circumstances, it seems somewhat unjust for the government to benefit from a windfall, with creditors not receiving funds that might otherwise be recouped by the liquidator for their benefit. Equally, it would be inappropriate for the company or its creditors to obtain a windfall from a compensation order where they have not

---

103 Australian Securities and Investments Commission, *Submission No 49 to Inquiry into Penalties for White Collar Crime* (April 2016), 10 [28]–[29].

104 Ibid 16 [52].

105 Ibid 11 [30], 16–17 [56].

suffered a loss. While this is unlikely in the phoenix context, it is certainly a possibility in other contexts. For this reason, we support a disgorgement power in favour of ASIC.

2 *Increase the relevant civil and criminal penalties*

The statutory maximum pecuniary penalty available under the civil penalty regime is $200,000 per contravention of the directors' duties. The quantum of the pecuniary penalty was set in 1993 and has never been adjusted for inflation. In our opinion, it is too low. The maximum pecuniary penalty is significantly lower than the legislative maximum penalties in other areas of Australian law[106] and dramatically lower than those in other major common law jurisdictions.[107]

Although $200,000 per contravention may sound like a large sum, the practical reality of directors' duties enforcement is that the courts rarely impose penalties anywhere near the maximum, even in matters involving several contraventions. From 2005 to 2014, the median civil pecuniary penalty imposed for breaches of directors' duties was $50,000.[108] During this same period, the courts only imposed four fines for criminal breaches of directors' duties of $4,000, $10,000, $10,000 and $75,000.[109] To overcome this apparent judicial reluctance, much higher legislative maximums are required in order to send a signal to the courts that the legislature intends for the penalties imposed by courts to increase accordingly.

While the proposed amendments to s 1317H should enhance deterrence of breaches of directors' duties, it is also important to ensure that those who engage in such activity are subject to punitive as well as remedial orders. If there is only a risk of a remedial order, more determined fraudsters may consider it worth the risk to engage in illegal phoenix activity if the worst that can happen is that they will lose the benefit they gained from doing so. It is critical that the severity of the sanctions significantly outweighs the benefits of engaging in the illegal conduct, so the pecuniary penalties for breaches of directors' duties must be substantial. We support an increase in the maximum pecuniary penalty under the civil penalty regime for a breach of the directors' duties from $200,000 to $500,000. This is the maximum civil penalty that is currently able to be imposed on individuals who contravene the cartel conduct provisions and other restrictive trade practices under the *Competition and Consumer Act 2010* (Cth).[110]

---

106 Australian Securities and Investments Commission, *Report 387: Penalties for Corporate Wrongdoing* (March 2014) 21–2 [73]–[74] <http://download.asic.gov.au/media/1344548/rep387-published-20-March-2014.pdf>.

107 Australian Securities and Investments Commission, *Report 387: Penalties for Corporate Wrongdoing* (March 2014) 5 [9], 18–9 [64], 25 [82]–[84] <http://download.asic.gov.au/media/1344548/rep387-published-20-March-2014.pdf>; Australian Securities and Investments Commission, Submission No 49 to *Inquiry into Penalties for White Collar Crime* (April 2016) 9–10 [25]–[27].

108 Jasper Hedges, Helen Bird, George Gilligan, Andrew Godwin and Ian Ramsay, 'An Empirical Analysis of Public Enforcement of Directors' Duties in Australia: Preliminary Findings' (Working Paper No 105, Centre for International Finance and Regulation, March 2016) 2, 26, 29, 33 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2766132>.

109 Ibid 27.

110 *Competition and Consumer Act 2010* (Cth) ss 76(1), 76(1B), pt IV.

The maximum fine for a criminal breach of the directors' duties has increased over the same period (1993 to present) from $200,000 to $360,000 as the fine is tied to the value of a 'penalty unit' which is intermittently adjusted.[111] This is less than half the maximum fine available for other similarly serious criminal offences under the *Corporations Act*, such as market manipulation, false or misleading statements, dishonest conduct and insider trading. They each attract a maximum criminal fine of the greater of 4,500 penalty units (currently $810,000), or three times the benefit gained, or both.[112] With regard to the importance of ensuring consistency of penalties for similarly serious offences, the Attorney-General's Department's *Guide to Framing Commonwealth Offences* provides:

> A penalty should be consistent with penalties for existing offences of a similar kind or of a similar seriousness. This should include a consideration of existing offences within the legislative scheme and other comparable offences in Commonwealth legislation such as the Criminal Code.[113]

Accordingly, we recommend that the statutory maximum criminal fine for breaches of directors' duties be increased to 4,500 penalty units so as to achieve consistency with other similarly serious offences under the *Corporations Act*. While these increases to the maximum civil penalty and criminal fine are substantial, we emphasise that these are the *maximum* penalties available for the most egregious of contraventions and offences and, in practice, would rarely be imposed.[114]

Another widely adopted approach to setting administrative, civil and criminal financial penalties in general[115] is to set the penalty as the greater of a fixed number or a multiple of the gain derived from the unlawful conduct. The rationale behind this approach is to ensure that the sanction outweighs the benefit of engaging in the unlawful conduct. This deserves further consideration. On the one hand, allowing the courts to order a pecuniary penalty that is a multiple of the benefit gained could result in a situation where the profits are effectively stripped from the defendant

---

111 *Corporations Act 2001* (Cth) Schedule 3 item 30 imposes a maximum fine of 2000 penalty units which equates to $360,000. A penalty unit is defined in *Crimes Act 1914* (Cth) s 4AA.

112 *Corporations Act 2001* (Cth) sch 3, item 310; *Crimes Act 1914* (Cth) s 4AA.

113 Australian Government, Attorney-General's Department, *A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers* (September 2011) 39 [3.1.2].

114 Our empirical research indicates that the courts rarely impose penalties anywhere near the maximum, even in matters involving several contraventions. In the ten year period from 2005 to 2014, the median civil pecuniary penalty imposed for breaches of directors' duties was $50,000, which is just 25% of the maximum penalty of $200,000. This median is calculated based on 27 pecuniary penalties imposed on defendants who contravened directors' duties provisions of the Corporations Act but were not found to have engaged in any other unlawful conduct during the period 1 January 2005 to 31 December 2014. During this same period, the courts only imposed four criminal fines for breaches of directors' duties of $4,000, $10,000, $10,000 and $75,000, the highest of which is only 21% of the current maximum fine of $360,000. Under the proposed increases, past judicial practice suggests that the typical pecuniary penalty would be around $100,000 (25% of $500,000) while criminal fines may range up to $170,000 (21% of $810,000).

115 For example, this approach is adopted by Singapore, New Zealand, the United States and Hong Kong in relation to civil or administrative pecuniary penalties for certain forms of wrongdoing. It is also adopted by Australia and Canada in relation to criminal fines for certain offences. It is also worth noting that the United Kingdom and Hong Kong have unlimited civil or administrative pecuniary penalties for certain wrongs, while the United Kingdom and Singapore have unlimited criminal fines for certain offences: see Australian Securities and Investments Commission, Submission No 49 to *Inquiry into Penalties for White Collar Crime* (April 2016) 8–10.

twice, once via s 1317H and once via a pecuniary penalty set as a multiple of the benefit gained. While it is critical that illegal phoenix operators are punished and the severity of the sanctions significantly outweighs the benefit of the unlawful conduct, it is equally important that the severity of the sanctions is not disproportionate to the unlawful conduct and that the punishment ‘fits the crime’. On the other hand, setting the penalty is a matter of discretion for courts, so it is highly improbable that an unduly severe sanction will be imposed. However, that reality needs to be set against the predictable opposition that any increase in sanction in the ‘white collar’ context engenders. The fact remains that the bigger the stick to threaten wrongdoers, the more likely it is to be scuttled by politicians reacting to scaremongering.

PART V – CONCLUSION

The many attempts to create a specific illegal phoenix activity prohibition can be explained by concerns with the ongoing harm caused by this activity and the apparent under-enforcement of existing laws that potentially deal with this activity. The failure of existing measures to adequately deter phoenix activity means that it continues to cause harm and it also leads to calls for the creation of a specific illegal phoenix activity prohibition. For a variety of reasons, this has not happened yet. We have suggested an alternative approach that has the potential to send a valuable ‘anti-phoenixing’ message to the market place. This message is that the gain from illegal phoenix activity will be lost and a substantial penalty will be imposed. Parliament acting on this issue will also send a signal to ASIC about the government’s enforcement priorities and the seriousness of this costly behaviour.