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DIRECTORS' LIABILITY FOR FRAUDULENT PHOENIX ACTIVITY – A COMPARISON OF THE AUSTRALIAN AND UNITED KINGDOM APPROACHES

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ABSTRACT

Fraudulent phoenix activity is a matter of widespread concern in Australia following a 2009 Treasury Paper. While there is broad support for its eradication, there is little agreement on the means by which this may be achieved and a general reluctance to do anything that might adversely affect business. The UK has long had laws specifically designed to deal with phoenix companies that reuse the liquidated company's name, as well as a vigorous program of director disqualification. This article compares Australia's existing and proposed laws to those in the UK. The incidence of fraudulent phoenix activity continues to grow in Australia despite corporate and taxation laws that apparently address it and in the absence of some of the characteristics existing in the UK that might nourish it: an active rescue culture and the availability of pre-packaged administrations. The article seeks to draw some conclusions of value to both countries.

KEYWORDS

Fraudulent phoenix activity, comparison, Australia and United Kingdom, reform proposals

A. INTRODUCTION

Phoenix activity occurs when a company "dies" but its business survives and is carried on through another company, with the aim of avoiding some or all of its legal obligations. In the United Kingdom, it is known as "phoenix syndrome" or "phoenixism". This may occur through successor companies or the use of related companies in a corporate group, either through the transfer of an insolvent company's business to another entity in the group or else the deliberate undercapitalisation of a subsidiary with the intention of quarantining its debts from the activities of the rest of the group. The term is generally pejorative[1] and is used to capture the abuse of the corporate form for the deliberate avoidance of debts. The Cork Report spoke of

> a widespread dissatisfaction at the ease with which a person trading through the medium of one or more companies with limited liability can allow such a company to

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[1] Note the neutral use of the expression "phoenix firms" in the 'FSA factsheet for Authorised Firms: Phoenix Firms' SFDFS108 8/12.

> become insolvent, form a new company, and then carry on trading much as before, leaving behind him a trail of unpaid creditors, and often repeating the process several times.[2]

However, it is notoriously difficult to define the undesirable form of the behaviour because its essential characteristics - the rebirth of a failed business in a new corporate guise - are also found in successful business rescues following periods of administration. For that reason, it shall be described here as fraudulent phoenix activity.

The purpose of this article is to compare the Australian and UK approaches to fraudulent phoenix activity. There has been a recent resurgence of interest in Australia, brought about by a realisation that it is responsible for millions of dollars of lost tax revenue.[3] In addition, it causes substantial deficiencies in retirement savings through the non-remittance of compulsory superannuation contributions, and also results in unpaid employee entitlements – wages, leave and redundancy amounts – that increase reliance on the Australian Government's safety net scheme, currently in the form of the Fair Entitlements Guarantee.[4] Following a damning paper from Treasury in 2009,[5] the Australian Government announced that it would introduce a suite of reforms to tackle fraudulent phoenix activity, one of which was "similar names" legislation modelled on s 216 of the Insolvency Act 1986 (UK). However, this proposed legislation attracted no support[6] and no draft provisions were ever introduced into Parliament.

This article will examine the range of anti-fraudulent phoenix activity laws existing and proposed in Australia and compare them to those used in the UK. Two points are of particular interest to UK scholars: fraudulent phoenix activity continues to flourish in Australia despite the decline in the popularity of rescuing companies or their businesses through voluntary administration; and recent Government efforts to eradicate the behaviour, while broadly supported in principle, have been hard won and relatively minor. The article begins with some background on fraudulent phoenix activity, the ways in which it is manifested and the harm it causes. Next comes the consideration of its treatment in Australia, followed by the UK experience. A critical comparison of the two is made, highlighting strengths and weaknesses in both. The article ends with some thoughts about the future direction for corporate law reform in this area of value to both countries.

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[2] Kenneth Cork and Great Britain, Insolvency Law Review Committee, *Report of the Review Committee on Insolvency Law and Practice,* Cmnd 8558, 1982) (Cork Report) para 1813. The Company Law Review Steering Group in 2000 gave it a narrower definition, describing it occurring where assets were transferred by company controllers to their new company for an insufficient consideration, prior to the first company's liquidation. Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Completing the Structure: a consultation document from the Company Law Review Steering Group* (2000) para 13.102.

[3] Australian Government, Treasury, *Action Against Fraudulent Phoenix Activity Proposals Paper* (2009) (2009 Phoenix Proposals Paper) para 2.

[4] In November 2012, the Australian Parliament passed the Fair Entitlements Guarantee Act 2012 (Aust) (FEG Act). For liquidations occurring after 5 December 2012, the Fair Entitlements Guarantee (FEG) replaced the General Employee Entitlement and Redundancy Scheme (GEERS), a scheme of executive government, with one enshrined in legislation. Between 2000 and mid-2012, GEERS and its predecessor, the Employee Entitlements Redundancy Scheme (EESS), have paid $1,040,373,956.

[5] 2009 Phoenix Proposals Paper (n 3).

[6] This is discussed below in Section C.

B. BACKGROUND

All types of unsecured creditors can be the victim of fraudulent phoenix activity. The limited liability of company shareholders and the status of the company as a separate legal entity allow the unpaid debts of a company to be extinguished upon its liquidation and deregistration. In upholding these crucial corporate characteristics, company law facilitates the deliberate elimination of a company by its controllers for the purpose of avoiding revenue debts, employee entitlements, adverse judgments or contractual obligations, and allows the resurrection of the company's business through another entity.

The destructive consequences of fraudulent phoenix activity in many parts of the world are a concern to insolvency regulators.[7] In addition to the losses in revenue and superannuation (as pension contributions are known in Australia), there is a domino effect where unsecured trade creditors are affected because they typically have their own employees and creditors who will, in turn, suffer losses. Businesses that avoid their liabilities through fraudulent phoenix activity enjoy an unfair advantage over competitors who abide by the law, thereby encouraging the wider adoption of this highly damaging practice.

Fraudulent phoenix activity may involve successor companies, where a newly incorporated company replaces the defunct one, or may arise in the corporate group context. The Australian Treasury's 2009 Phoenix Proposals Paper, noted in the next section, described a newly formed company taking over the business of a previously liquidated entity which has failed to pay its debts as the "basic" form of phoenixing,[8] and phoenix activity within corporate groups as the "sophisticated" form.[9] Typically under the sophisticated form, a labour hire entity with few assets within a corporate group incurs substantial liabilities by way of employee entitlements and taxes. If they are "lucky", the employees may be transferred to another entity in the group to continue their employment, but may not be paid their accrued entitlements.[10] This process is not only used for debt avoidance but can also be used for industrial relations reasons.[11]

The laws of both the UK and Australia would seem to deal adequately with such behaviour through the enforcement of directors' duties or via the limited rights available through common law veil piercing.[12] However, the capacity of fraudulent phoenix activity to mimic

[7] See for example, Paul Appleby and the International Association of Insolvency Regulators, 'The Regulation of Phoenix Companies' (2004) <http://www.insolvencyreg.org/sub_publications/docs/Report%20on%20Phoenix%20Companies%20Final41029.pdf> accessed 10 October 2013.
[8] ibid [1.1.2].
[9] ibid.
[10] See for example, *Fair Work Ombudsman v Ramsey Food Processing Pty Ltd* (No 2) [2012] FCA 408; also *Fair Work Ombudsman v Ramsey Food Processing Pty Ltd* (2011) 198 FCR 174.
[11] Instances which reached the courts include the 'Waterfront dispute' (*Maritime Union of Australia v Patrick Stevedores No. 1 Pty Ltd (under administration) (ACN 003 621 645)* [1998] FCA 378); Mount Schank Meats (*Australasian Meat Industry Employees' Union v Rashad Basha Aziz* [1998] FCA 925); the Coogi group *(Re Coogi Nominees Pty Ltd (administrators apptd); McCluskey v Karagiozis* (2002) 120 IR 147; and *Burswood Catering and Entertainment Pty Ltd v Australian Liquor, Hospitality and Miscellaneous Workers Union, WA Branch* (2002) 131 IR 424.
[12] See most recently, *Prest v Petrodel Resources Limited* [2013] All ER (D) 90 (Jun). Also, *Gilford Motor Co Ltd v Horne* [1933] Ch 935; *Jones v Lipman* [1962] 1 WLR 832; *Woolfson v. Strathclyde Regional Council* (1979) 38 P & CR 521, [1978] SLT 159; *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 3 All ER 462; [1976] 1 WLR 852; *Adams v Cape Industries Plc* [1990] Ch 433 and other veil

proper corporate rescue efforts makes it difficult to discern cases involving impropriety, and few cases are actioned through the courts. Other factors can exacerbate an indifference to this damaging behaviour. In both countries, vulnerable creditors such as employees are reasonably well protected through statutory priority[13] and government funded schemes.[14] Creditors generally are expected, in theory at least, to protect themselves against non-payment, either through taking security or through a variety of ex ante protection mechanisms.[15]

Where a Government has adopted a business rescue culture, the incentives to tighten laws or increase the number of actions against fraudulent phoenix operators diminish even further. Both the UK and Australia have recognised that many companies in financial difficulties have businesses that could be saved, and that forcing such companies into liquidation reduces the return for creditors and results in loss of employment. In the UK, the Cork Report in 1982 made a series of recommendations to "to encourage, wherever possible, the continuation and disposal of the debtor's business as a going concern and the preservation of jobs for at least some of the employees, and to remove obstacles which tend to prevent this."[16] In 1988, Australia's Harmer Report recommended the introduction of voluntary administration (VA),[17] noting that VA "will be worthwhile and a considerable advantage over present procedures if it saves or provides better opportunities to salvage even a small percentage of companies which, under the present procedures, have no alternative but to be wound up."[18]

In response to these reports, both countries introduced laws to encourage business rescue.[19] However, in more recent years, they have diverged, with the UK strengthening its rescue culture, including recognition of "pre-pack" administrations, and Australia moving away from it. A 2010 Treasury options paper suggesting that Australia introduce a "safe harbour"

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piercing cases referred to in *VTB Capital Plc v Nutritek International Corp* [2012] WLR(D) 181; [2012] EWCA Civ 808 (20 June 2012)[40] – [96].

13 In Australia, employee entitlements are prioritised by Corporations Act 2001, s556(1)(e) to (h); in the UK by Insolvency Act 1986, s 386 and Sch 6. In Australia, the claims of holders of floating charges (now called 'circulating security interests') are subordinated to employees as priority creditors: Corporations Act 2001, s 561. In the UK, see Insolvency Act 1986, s 175(2)(b). In both countries, debts owed to revenue authorities have lost their priority (Australia: Insolvency (Tax Priorities) Legislation Amendment Act 1993 (Aust); UK: Enterprise Act 2002).

14 Australia has the Fair Entitlements Guarantee, FEG (n 4); the UK has the National Insurance Fund, administered on behalf of the Secretary of State by Redundancy Payments Offices.

15 See generally F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) ch 2; R Posner, *Economic Analysis of Law* (5th ed, Aspen Publishers 1998); P Halpern, M Trebilcock and S Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law' (1980) 30 *University of Toronto Law Journal* 117; J Freedman, 'Limited Liability: Large Company Theory and Small Firms' (2000) 63 *Modern Law Review* 317; R Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386; R Flannigan, 'The Economic Structure of the Firm' (1995) 33 *Osgood Hall Law Journal* 105.

16 Cork Report (n 2) [1980, (2)].

17 Australian Law Reform Commission, *General Insolvency Inquiry* Report No 45 (1988) (the Harmer Report).

18 ibid Volume 1, 29 (emphasis added). Companies in financial difficulties could, pre-1993, be saved via a Scheme of Arrangement under Part 5.1 of the Corporations Act but with the requirement of two court hearings, Harmer found them to be 'particularly unsuited to the average private company with financial difficulties', ibid 26. An important difference between VAs and Schemes is that Schemes are also available for the re-organisation of solvent companies. See further C Anderson, 'Finding the Background of Part 5.3A of the Corporations Law' (1999) 10 *Australian Journal of Corporate Law* 107.

19 The Cork Report was followed in 1984 by a White Paper entitled *A Revised Framework for Insolvency Law*, (White Paper, Cmnd 9175, 1984), leading to the Insolvency Act 1986; the Harmer Report was the foundation for much of the Corporate Law Reform Act 1993. Prior to 1993, the Corporations Law had provided for schemes of arrangement, receivership and liquidation as well as a form of insolvency administration called 'official management' which was rarely used.

exception to insolvent trading liability, for the purpose of encouraging informal workouts, gained no support and did not proceed.[20] The Australian VA provisions are still available to creditors but their use has significantly diminished in recent years as liquidation has regained popularity.[21] One reason for this decrease appears to be disenchantment with VA by significant unsecured creditors such as the Australian Taxation Office (ATO).[22] This is not to say that the UK Government is ignorant of the capacity of business rescue to mask fraudulent phoenix activity. Right from the beginning, the Cork Report acknowledged that "[i]t is a basic objective of the law to support the maintenance of commercial morality and encourage the fulfilment of financial obligations. Insolvency must not be an easy solution for those who can bear with equanimity … their responsibility for the failure of a company under their management". [23] The problems and potential prejudice to the public interest arising out of "phoenix syndrome" were also acknowledged by the Final Report of the Company Law Steering Group in 2001.[24]

Australia's corporate regulator, Australian Securities and Investments Commission (ASIC), can take action with respect to fraudulent phoenix activity, but its deterrence does not need to be exclusively a matter for public enforcement. The traditional approach to directors who abuse their positions of power by making a gain for themselves at the expense of their companies is a private action for breach of fiduciary duties, actionable by the company itself or shareholders via derivative actions. However, where the company is insolvent and the external administrator chooses not to pursue this avenue, other mechanisms become especially important. One such is director disqualification, available in both jurisdictions on a variety of grounds. Another means of deterrence is a provision specifically designed to target fraudulent phoenix activity, actionable either by a regulator as a breach provision or via a civil suit for compensation by a creditor or external administrator. The Australian and UK versions of these various means will be considered in the next two Sections respectively.

C.THE TREATMENT OF FRAUDULENT PHOENIX ACTIVITY IN AUSTRALIA

A Ministerial press release in 2011 estimated that there were 6,000 phoenix companies in Australia.[25] The difficulties caused by phoenix companies have been publicly recognised in

[20] Australian Government, Treasury, 'Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration' January 2010.

[21] In 2012 - 13, approximately 14.5% of external administration appointments were voluntary administrations and 46.5% were creditor initiated liquidations. In comparison, in 2002 – 2003, when the popularity of VA reached its peak, the numbers were virtually the opposite, with approximately 44% and 18% respectively. ASIC, *Australian Insolvency Statistics*, Table 1.3.

[22] According to the ATO's submission to the Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004), "from discussions with practitioners, other creditors and other anecdotal evidence, Tax Office staff believe that a number of Deed of Company Arrangements [sic] are defaulted on, leading to the company being wound up and creditors failing to receive the amounts pledged under the deed." They also said "[t]he Tax Office supports the Voluntary Administration process, but believes that success of the process should be measured by the quantity of Deed of Company Arrangements [sic] which are actually complied with, rather than the number that are proposed and accepted by creditors". Comments from the Australian Taxation Office to the Parliamentary Joint Committee on Corporations and Financial Services, 'Inquiry into Australia's Insolvency Laws' (ATO, 2003) [30].

[23] Cork Report (n 2) [191].

[24] Department of Trade and Industry, *Modern Company Law for a Competitive Economy: Final Report* (London, 2001), [15.55 – 15.77]; see further S Griffin, 'Extinguishing the Flames of the Phoenix Company' (2002) *Current Legal Problems* 377.

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

Australia for nearly two decades,[26] but relatively little legislation has been enacted to tackle it. There are presently no laws in Australia which expressly proscribe "fraudulent phoenix activity" as such. The behaviour is currently dealt with through other mechanisms, and by a number of different agencies. Unlike the UK, Australia has a sole corporate regulator, ASIC.[27] However, fraudulent phoenix activity is also of concern to the Australian Taxation Office (ATO), the Fair Work Ombudsman (FWO)[28] and Fair Work Building and Construction (FWBC).[29]

In November, 2009, the Australian Government Treasury released a paper entitled "Action Against Fraudulent Phoenix Activity Proposals Paper" (2009 Phoenix Proposals Paper). It shows that the losses caused by phoenix activity have been mounting. The Government's attention has now been attracted, possibly because the annual losses to taxation authorities are estimated at around $600 million per annum.[30] Despite the range of options then available to regulators including the ATO and ASIC, the 2009 Phoenix Proposals Paper concluded that "[i]t is clear that ... existing mechanisms do not provide a sufficient disincentive to prevent fraudulent phoenix activity".[31]

Whether the relevant laws are inherently inadequate or insufficiently enforced is contentious. What is clear is that the available statutory provisions have been little used in relation to fraudulent phoenix activity. Under s 181(1) of the Corporations Act 2001, directors must exercise their powers in good faith in the best interests of the company and for a proper purpose. Under s 182(1) of the Act, directors must not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the corporation. These are actionable by the company itself or its shareholders through a statutory derivative action, by its liquidator and, unlike in the UK, by the corporate regulator, ASIC.

It would seem that these provisions nicely capture fraudulent phoenix activity and indeed there have been a number of actions brought, whether expressly described as "phoenix" or otherwise.[32] In the most recent, *ASIC v Somerville & Ors*,[33] eight directors were held to have

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[26] Parliament of Victoria, Law Reform Committee, '*Curbing the Phoenix Company: First Report on the Law Relating to Directors and Managers of Insolvent Corporations*' June 1994; Second and Third Reports, 1995; Australian Securities Commission, National Intelligence and Analytical Service, '*Project One: Phoenix Activities and Insolvent Trading*,' ASC Research Paper 95/01, 1995; Final Report of the Royal Commission into the Building and Construction Industry, 2003 (Cole Royal Commission), volume 8, chapter 12; Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004), chapter 8.

[27] The Insolvency and Trustee Service (ITSA) deals with personal insolvency, including bankruptcy and its alternatives.

[28] This is a statutory office created under the Fair Work Act 2009 (Aust) and is charged with ensuring compliance with Commonwealth workplace laws, including actions against companies (and their directors as accessories) for underpayments and non-payments of wages and other entitlements.

[29] This agency has an educational, investigatory and prosecutorial role in relation to rights and responsibilities in the Building and Construction industry. The Cole Royal Commission found that fraudulent phoenix activity was a particular problem in this industry.

[30] 2009 Phoenix Proposals Paper (n 3) [2].

[31] ibid.

[32] These include *Jeffree v NCSC* [1990] WAR 183, where a director of a company that faced an adverse commercial arbitration decision transferred the company's business name and assets to another company for insufficient consideration, and was found to have made improper use of information acquired in his position as a director. See also *R v Heilbronn* (1999) 150 FLR 43, where a director of a company with substantial sales tax liabilities stripped the company of its assets and transferred them to another company, and then to a third company. He was found to have knowingly and intentionally defrauded the creditors of the second company and, in doing so, made an improper use of his position as officer to cause detriment to that company.

acted in breach of their statutory directors’ duties for making asset transfers for an undervalue and thus engaging in illegal phoenix activity. Their solicitor, Somerville, who had concocted the schemes, was also found liable as an accessory to their breaches.[34] There are serious consequences for breaches of directors' duties that should be a powerful deterrent against phoenix activity. There is a range of civil penalty orders which a court can make on ASIC’s application: pecuniary penalties,[35] compensation[36] and disqualification of the director.[37] In addition, directors breaching these duties recklessly or with intentional dishonesty may be subject to criminal proceedings and penalties of up to $220,000, 5 years imprisonment or both.[38] Yet ASIC chooses to pursue few directors' duties cases where fraudulent phoenix activity is occurring, with those noted here among a small handful over an extended period of time.

ASIC has standing to seek disqualification by the court in relation to a breach of directors’ duties, with a lifetime ban being imposed in appropriate circumstances.[39] ASIC could also apply to the court to disqualify a director for up to 20 years, where the director has been involved in two or more failed companies in seven years, and “[the court] is satisfied that ... the manner in which the corporation was managed was wholly or partly responsible for the corporation failing, ... and the disqualification is justified”.[40] However, neither of these is used against phoenix operators. Instead, ASIC utilises its own disqualification power where it detects blatant fraudulent phoenix activity, resulting in relatively short banning periods for directors.[41] It may disqualify a director for up to five years where an adverse liquidator’s report has been lodged showing that the director has been involved in two or more failed companies in seven years.[42] It appears the easy and cheap enforcement option is preferred over seeking the removal of directors involved in fraudulent phoenix activity for a substantial period of time. Moreover, no consideration appears to be given to recovering compensation from the errant director,[43] which could be distributed by the company’s liquidator to the creditors affected by the behaviour.

While it is disappointing to see the powerful directors' duties provisions so little utilised in the fight against fraudulent phoenix activity, it is even more discouraging that the laws proscribing the deliberate removal of corporate assets to defeat employee claims have never been used. A company’s liquidation allows action to be taken under s 596AB of the

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33 (2009) 77 NSWLR 110.
34 ibid [42].
35 Corporations Act, s 1317G.
36 ibid s 1317H. The company’s liquidator may also take action to recover compensation for the company.
37 ibid s 206C.
38 ibid s 184 and Sch Three.
39 ibid s 206C and accompanying text.
40 Corporations Act 2001, s 206D(1)(b).
41 See for example, ASIC, *10-172AD ASIC disqualifies 13 directors of failed companies from managing corporations* <http://www.asic.gov.au/asic/asic.nsf/byheadline/10-172AD+ASIC+disqualifies+13+directors+of+failed+companies+from+managing+corporations?openDocument> (accessed 22 August 2013). See also ASIC, *05-198 Melbourne woman banned from managing corporations for five years* <http://www.asic.gov.au/asic/asic.nsf/byheadline/05-198+Melbourne+woman+banned+from+managing+corporations+for+five+years?openDocument> (accessed 22 August 2013).
42 Corporations Act 2001, s 206F. This is a report under s 533 which relates to the misapplication of company assets, breaches of duty, or the fact that the company may be unable to pay its creditors more than 50 cents in the dollar. ASIC’s power to disqualify under this section is contingent on the company being in liquidation rather than voluntary administration or simply deregistered by ASIC.
43 ibid s 1317H.

Corporations Act 2001, either by ASIC or the liquidator, against directors entering into transactions with the intention of preventing the recovery of the entitlements of employees of a company, or significantly reducing the amount of the entitlements of employees of a company that can be recovered. The object of s 596AB, introduced in 2000,[44] is "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".[45] It is possible that the intention element, which must be established subjectively rather than on an objective "reasonable person" standard, has discouraged ASIC and company liquidators from mounting a case under the section. In 2004, a parliamentary committee acknowledged that the law was a failure and recommended its amendment but nothing further has been done.[46]

Likewise, ASIC has not launched any proceedings in relation to uncommercial transactions that are now actionable as insolvent trading.[47] The insolvent trading laws impose a duty on company directors to prevent the company trading while it is insolvent. The duty applies when a new debt is incurred when a company is insolvent or where it becomes insolvent through the incurring of that debt. To broaden their reach, the insolvent trading laws were amended in 2000[48] so that incurring a debt includes an "uncommercial transaction", where, for example, the director has sold company assets at an undervalue. The effect of this amendment is to permit ASIC to seek civil penalty or criminal sanctions for the behaviour.[49] However, this amendment does not take away the other requirements of insolvent trading, including that the company must be insolvent at the time, or become insolvent as a result of the transaction. A director who strips the company of assets by entering into an uncommercial transaction immediately prior to insolvency therefore avoids liability for the augmented form of insolvent trading. A recommendation that the insolvency requirement be removed[50] to assist in achieving the objective of deterring asset stripping was not acted upon.

Surprisingly, where the ATO is the unsecured creditor, fraudulent phoenix activity continues to flourish. This is despite a wide range of general and specific provisions that, notionally at least, should be adequate to deal with the behaviour.[51] The ATO has found itself unable to prosecute using the general anti-avoidance rule (GAAR) in the Income Tax Assessment Act 1936 in relation to phoenix activity. One senior ATO official said in 2009, in relation to

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[44] Corporations Law Amendment (Employee Entitlements) Act 2000 (Aust).

[45] Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000, [18].

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

[47] Corporations Act 2001 (Aust) Part 5.7B Div 3. Liability is imposed via s 588G.

[48] The Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000, [10]. acknowledged that: "The inclusion of uncommercial transactions in s 588G(1A) has implications for the protection of employee entitlements, the prosecution of directors involved in 'phoenix' activity and recovery actions by liquidators for the benefit of creditors generally."

[49] In addition, the liquidator has the ability to recover from directors the undervalue of assets deliberately dispersed by them: s588FB.

[50] 2004 Stocktake Report (n 46) [4.60], Recommendation 13.

[51] The Crimes (Taxation Offences) Act 1980 (Aust) already imposes criminal sanctions where a person enters into an arrangement with the intention of securing that a company will be unable to pay a range of taxes. Aiding and abetting such an arrangement by another is also covered. The penalties are 10 years imprisonment or 1,000 penalty units or both. The existence of these penalties is publicised by the ATO via its taxpayer alerts. (See for example, Taxpayer Alert TA2008/16 Liquidation of entities to avoid the payment of tax liability). However, it is possible that this criminal offence, requiring proof of the accused's intention beyond reasonable doubt, is simply too difficult to establish. There are also penalties that can be imposed under the Criminal Code s 135.1 for defraud or under s 135.4 for conspiracy to defraud.

phoenix activity, "[t]he problem is that when we take action our collection rate is six per cent. We just do not have the powers to collect the money."[52]

Australia has a "director penalty notice" (DPN) regime that has, since 1993, imposed personal liability on directors for "Pay As You Go" (PAYG) income taxes deducted from employees' wages, where they have not been remitted to the ATO.[53] These unremitted taxes are one of the major losses caused by fraudulent phoenix activity. However, liability may be avoided if the director places the company into liquidation or VA within 21 days of receiving the notice, or if one of a number of narrow defences is established. Harsh though these laws may seem, they have proved ineffective against fraudulent phoenix activity because the directors concerned have already placed their companies into liquidation or VA as part of the phoenixing process, thereby avoiding liability. In 2010, the capacity of the Commissioner of Taxation to seek security bonds from directors suspected of repeat fraudulent phoenix activity was enhanced,[54] but relatively few of these bonds have been sought.[55]

One of the key difficulties with the DPN regime has always been detection. The imposition of liability is dependent on the ATO knowing that the taxes were owing but not remitted, and then issuing a DPN. The non-reporting and non-payment of these withholding taxes do not become apparent until the end of the financial year, by which time liabilities have reached a significant amount. The 2009 Phoenix Proposals Paper noted the resource-intensive nature of the imposition of a DPN by the ATO, which meant that many directors escaped liability.[56] Proposed legislation in late 2011 to "automate" the imposition of DPNs[57] faced strong opposition from the business community on the basis that it would unfairly penalise "innocent" directors,[58] and was not successful. The laws that did pass in 2012[59] in relation to tightening the operation of the DPN regime were a watered down version of those originally proposed, and did little to overcome the detection problem.[60] Beneficially for employees, unpaid superannuation entitlements, enforceable through the taxation system,[61] were included in the DPN regime from 2012.[62]

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[52] Testimony before the Joint Committee of Public Accounts and Audit, Parliament of Australia, PA 26, October 2009, by Mark Konza, Deputy Commissioner of Taxation, Small and Medium Enterprises.
[53] Taxation Administration Act 1953 (Aust), Schedule 1.
[54] Tax Laws Amendment (Transfer of Provisions Act) 2010 (Aust).
[55] In 2010-2011, the ATO issued 10 security bond demands to phoenix operators relating to an existing or future debt: Australian Government, Australian Taxation Office, *Annual Report 2010-2011*, 102. No statistics on the number of bonds requested were given in the ATO's 2011-2012 Annual Report, although it did mention that the ATO was implementing the security bond demand legislation. At 73. It also reported that it had conducted 115 reviews and audits of businesses suspected of phoenix activity, raising liabilities of $56 million. ibid.
[56] 2009 Phoenix Proposals Paper (n 3) [3.1.1].
[57] Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-Compliance Tax Bill 2011.
[58] See for example, the submission to Treasury of the Taxation Committee of the Business Law Section of the Law Council of Australia <http://www.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/docs-2300-2399/2324%20Options%20to%20Address%20Fraudulent%20Phoenix%20Activity.pdf> (accessed 26 August 2013)
[59] Tax Laws Amendment (2012 Measures No. 2) Act 2012; Pay As You Go Withholding Non-compliance Tax Act 2012.
[60] In particular, the ATO is still required to issue a DPN in every case. While the 2012 legislation did remove the ability of directors to avoid personal liability if liabilities were unreported and unpaid three months after they become due, it is still necessary for the ATO to have discovered the liability to tax in the first place.
[61] Superannuation Guarantee Charge Act 1992 (Aust) and Superannuation Guarantee (Administration) Act 1992 (Aust).
[62] Tax Laws Amendment (2012 Measures No. 2) Act 2012, Schedule One.

In late 2011, two further Bills to target fraudulent phoenix activity were released for public comment. The Bills were part of the Government's fulfilment of a 2010 pre-election commitment.[63] Upon the release of the two Bills, the Parliamentary Secretary to the Treasurer, the Hon David Bradbury, claimed that "[t]his will stop directors from exploiting the limited liability protections in the corporations law to avoid having to pay any debts, including workers' entitlements, that they incur in a 'phoenix' company." [64]

One Bill, which became the Corporations Amendment (Phoenixing and Other Measures) Act 2012 ("Phoenixing Act"), passed with little objection in May 2012.[65] The Phoenixing Act gives ASIC the power to order the winding up of a company and to appoint a liquidator where it becomes apparent that it is not carrying on business, evidenced for example by the non-return of ASIC forms or the non-payment of fees.[66] This is intended to overcome the problem of companies which remain dormant with unpaid debts, where no creditor seeks the appointment of a liquidator. However, the stated aim of the Act was not to benefit creditors generally through the liquidator bringing action but rather to allow employees to have access to the taxpayer funded safety net scheme for unpaid wages and other entitlements for employees of insolvent employers, [67] one of the requirements of which is the liquidation of the employer. It surely would have been simpler for the Government to change this requirement of its own scheme, but the reason for not doing so was never articulated. In addition, the Phoenixing Act allows for the publication of corporate insolvency notices through a single, publicly available website.[68]

The second piece of proposed legislation, the Corporations Amendment (Similar Names) Bill 2012 ("Similar Names Bill"), did not progress past the exposure draft stage. The Bill provided that a director of a failed company can be jointly and individually liable for the debts of a company that has a similar name to a pre-liquidation name of the failed company.[69] Certain time limits were specified.[70] According to the Bill, the court may make exemptions "where the person has acted honestly, and having regard to all the circumstances of the case, the person ought fairly to be exempt,"[71] 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

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[63] Australian Labor Party, 'Protecting Workers' Entitlements Package', 25 July 2010 <http://www.aist.asn.au/media/38043/2010.07.26_protectingworkersentitlementspackage.pdf> (accessed 26 August 2013).

[64] The Hon David Bradbury, Media Release no 66, 'Gillard Government Releases Draft Laws to Crack Down on 'Phoenixing' 20 December 2011 <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/066.htm&pageID=003&min=djb&Year=&DocType> (accessed 26 August 2013).

[65] The Bill was examined by the House of Representatives Standing Committee on Economics, which found that "'the bill comprises uncontroversial measures that will assist in curbing the amoral practice of phoenixing." Commonwealth, *Parliamentary Debates*, House of Representatives, 27 February, 2012 (Julie Owens). The Senate Economics Legislation Committee Report was also broadly supportive of the Bill, with recommendations for only minor amendments. The Report contained a Coalition Senators' Dissenting Report.

[66] Corporations Amendment (Phoenixing and Other Measures) Act 2012, s 489F.

[67] The General Employee Entitlements and Redundancy Scheme (GEERS) and its replacement, the Fair Entitlements Guarantee. This was one of the major advances which the Parliamentary Secretary trumpeted in announcing the proposed legislation. See Explanatory Document accompanying the release of the legislation; see also the Parliamentary Secretary's press release No 066 (n 64).

[68] See Australian Securities and Investments Commission (ASIC), 'Insolvency notices' <https://insolvencynotices.asic.gov.au/> (accessed 26 August 2013).

[69] Corporations Amendment (Similar Names) Bill 2012, s 596AJ(1).

[70] ibid s 596AJ(1)(b) and (d).

[71] ibid s 596AK(3).

failed company have become assets of the debtor company".[72] An exemption would be granted if the failed company has paid its debts in full.[73] However, submissions to Treasury in response to the Bill's exposure draft noted the ease with which liability could be avoided[74] and criticised the lack of a definition of fraudulent phoenix activity,[75] and no more was heard of it.

It would be fair to conclude that while the Australian Government is genuinely concerned about fraudulent phoenix activity, their legislative efforts to constrain it have been token and largely ineffective. The efforts of its regulators in enforcing the existing laws have been little better. [76] The Inter-agency Phoenix Forum (IAPF)[77] was established in 2011 to try to coordinate responses and share information relating to phoenix activity,[78] but nothing substantive has yet been claimed from this collaboration. ASIC has had at its disposal since 2005[79] the Assetless Administration Fund (AAF),[80] provided by the Government to finance insolvency practitioners in their work on behalf of companies with little or no assets. The aim of the fund is to overcome the inability of liquidators to make proper investigations due to financial constraints.[81] AAF funding is only available for investigations where director banning proceedings by ASIC may be appropriate,[82] or where court proceeding for serious

[72] ibid s 596AK(4)(b).
[73] ibid s 596AN.
[74] See for example, the submission of Chartered Secretaries Australia, 23 January 2012 <http://www.csaust.com/media/287480/fina_submission_corps_act_amendment_similar_names.pdf>(accessed 26 August 2013).
[75] See for example, the submission of the Australian Institute of Company Directors, 29 February 2012 <http://www.companydirectors.com.au/Director-Resource-Centre/Policy-on-director-issues/Policy-Submissions/2012/~/media/Resources/Director%20Resource%20Centre/Policy%20on%20director%20issues/2012/Corporations%20Amendment%20Similar%20Names%20Bill%20201229%20Feb%202012.ashx> (accessed 26 August 2013).
[76] There are some notable exceptions. In a recent case involving a serial phoenix operator, the Fair Work Ombudsman (FWO) obtained court orders requiring a director to place nearly a million dollars, transferred as part of a phoenix transaction, into a trust to be distributed to employees. *Fair Work Ombudsman v Ramsey Food Processing Pty Ltd* (No 2) [2012] FCA 408 (20 April 2012).
[77] See Australian Taxation Office, 'Inter-Agency Phoenix Forum' <http://www.ato.gov.au/Business/Consultation--Business/In-detail/Inter-Agency-Phoenix-Forum/About/Inter-Agency-Phoenix-Forum/> (accessed 26 August 2013).
[78] Its members include ASIC, the ATO, the Australian Consumer and Competition Commission (ACCC), the Department of Education, Employment and Workplace Relations (DEEWR) and FWO.
[79] ASIC, '05-312 ASIC welcomes insolvency reforms package', 13 October 2005 <http://www.asic.gov.au/asic/asic.nsf/byheadline/05-312+ASIC+welcomes+insolvency+reforms+package?openDocument> (accessed 26 August 2013).
[80] See ASIC, 'Assetless administration fund' <http://www.asic.gov.au/asic/asic.nsf/byheadline/Assetless+Administration+Fund?openDocument> (accessed 26 August 2013).
[81] ASIC, *Regulatory Guide 109: Assetless Administration Fund: Funding Criteria and Guidelines*, November, 2012, RG109.1. There is a cap, currently $7,500, or $8,250 once GST is included, on the amount of funding provided. ibid RG109.41. Approval for funding over $7,500 may be given only where ASIC considers the extent and nature of the work proposed to be undertaken is necessary and justifies the additional cost; and ASIC and the liquidator come to an agreement on the amount of funding. RG 109.42.
[82] ASIC has provided statistics on the number of director bannings funded by the AAF. See ASIC, 'Insolvency practitioners complaints statistics' <http://www.asic.gov.au/asic/asic.nsf/byheadline/Insolvency+practitioners+complaints+statistics?openDocument> (accessed 26 August 2013). Between July 2006 and December 2011, 332 directors were banned and 193 of those were as a result of funding from the AAF.

misconduct pursuant to the Corporations Act may be warranted.[83] Its Regulatory Guide 109 indicates that "[a] particular focus of the AA Fund is to curb fraudulent phoenix activity".[84]

However, in order to qualify for AAF funding, the liquidator must have obtained sufficient evidence to support the banning or enforcement action.[85] The scheme therefore relies on substantial inquiries being undertaken by a liquidator in the first place, and the paperwork required to apply for funding is substantial.[86] This is surely a "chicken and egg" argument: access to the fund depends on a liquidator of a company, which by definition is assetless, being willing to make investigations at their own expense to come up with the evidence sufficient to support their application for funding. It was this very reluctance to expose themselves to personal expense that the AAF was set up to overcome.

Thus, fraudulent phoenix activity continues to flourish in Australia despite the move away from corporate rescue through VAs. The next Section examines the laws governing phoenix companies in the UK, following which Section E will compare and critically analyse the response of both countries.

D. THE TREATMENT OF "PHOENIX SYNDROME" IN THE UNITED KINGDOM

The Cork Report in 1982 made a series of candid remarks about fraudulent phoenix activity and law reform:

> The activities of 'cowboys' and 'fly-by-night' operators are much publicised. They clearly constitute an ever-present risk to ordinary members of the public. … [I]t will never be possible to stamp out entirely practices of this kind; nor is it easy to devise satisfactory solutions to the problems. It will, however, be a matter of reproach if the law remains complacent and fails to make any attempt to deal with everyday problems created by firms or companies which cease to trade, leaving work which has been paid for in advance uncompleted, but whose promoters are at liberty immediately to start afresh under a new name.[87]

Some of the changes brought about in response to the Cork Report through the Insolvency Act 1986 (UK) are discussed later in this Section. Despite its misgivings over phoenix companies, one of Cork's greatest legacies is the "rescue culture"[88] that encourages the saving of insolvent businesses. This culture has become part of the British insolvency landscape,[89] and was augmented by reforms introduced through the Enterprise Act 2002.[90]

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[83] Regulatory Guide 109 (n 81) RG109.26
[84] ibid RG109.4.
[85] ibid RG 109.37 – RG 109.39.
[86] There are ten appendices to Regulatory Guide 109.
[87] Cork Report (n 2) [1742].
[88] See Parliament of the United Kingdom, Department of Trade and Industry, The Insolvency Service, *Insolvency – A Second Chance*, *Productivity and Enterprise* (Cm 5234, 2001) [2.1]. See generally G McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Cheltenham, Glos., Edward Elgar, 2008), Chapter 3. For a discussion of the UK attitude to entrepreneurs, see C Bradley, 'Enterprise and Entrepreneurship: The Impact of Director Disqualification' (2001) 1 *Journal of Corporate Law Studies* 53, 63 – 68.
[89] See also, Parliament of the United Kingdom, Department of Trade and Industry, *Our Competitive Future: Building the Knowledge Driven Economy* (Cm 4176, 1998). Note the remarks of Peter Mandelson MP, then Secretary of State at the Department of Trade and Industry, quoted in V Bavoso and J P Tribe, 'Phoenix Companies: Do Directors Learn Form Failure?' (2011) < http://ssrn.com/abstract=2117241> (accessed 26 August 2013).

While the political language of "serial entrepreneurs" was replaced by the less frightening "responsible risk takers",[91] the Enterprise Act was heralded as "transforming our approach to bankruptcy and corporate rescue … We believe that promoting enterprise will release the entrepreneurial skills of the British people. … Companies in financial difficulties must not be allowed to go to the wall unnecessarily".[92]

The goal of rescuing saveable companies is articulated in the Insolvency Act 1986, where the first objective of administration is "[rescuing] the company as a going concern", failing which the administrator should maximise returns to creditors as a whole or realise property for distribution to secured or preferred creditors.[93] A genuine rescue of the original company means that the creditors retain their rights to be paid the amounts owed to them,[94] and phoenixing is not an issue. On the other hand, any sale of the business to another party, whether before or after the appointment of the liquidator, and whether to a related party or not, frequently results in the creditor being paid less than they are owed.

The Enterprise Act 2002 introduced provisions for the appointment of an administrator to be made out of court,[95] and has contributed to an apparent increase in the numbers of pre-packaged administrations[96] since the reforms came into effect.[97] The "pre-pack", as it is known, is not a formal procedure set out in the Act. According to Statement of Insolvency Practice 16 (SIP 16), it is "an arrangement under which the sale of all or part of the company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on or shortly after his

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[90] Section 248 of the Enterprise Act 2002 replaced the administration provisions of the Insolvency Act 1986 with new provisions now located in Schedule B1. The Act removed the ability of holders of floating charges created after 15 September, 2003 to appoint administrative receivers, on the basis that receiverships gave too much power to floating charge holders at the expense of other creditors. For example, they might liquidate a company that could otherwise been saved. See Insolvency Act 1986, s 72A.

[91] G Wilson, 'Business, State, and Community: 'Responsible Risk Takers', New Labour, and the Governance of Corporate Business' (2000) 27 *Journal of Law and Society* 151, 172; G Wilson and S Wilson, 'Responsible Risk-Takers: Notions of Directorial Responsibility – Past, Present and Future' (2001) 1 *Journal of Corporate Law Studies* 211.

[92] *Insolvency – A Second Chance* (n 88), Foreword by the Rt Hon Patricia Hewitt. See also the speeches referenced in Wilson, 'Governance of Corporate Business' (n 91).

[93] Insolvency Act 1986 (UK), Schedule B1 [3](1).

[94] The rescue of the company may involve a creditor agreeing to be paid less than originally owed, or a swap of debt for equity in a restructured company.

[95] Previously a court order was required, but according to the Insolvency Act 1986, Sch B1, an administrator can be appointed by a floating charge holder, (para 14) or the company or its directors (para 22). The removal of the need for court approval has facilitated the speedy pre-pack process taking place before the meeting of creditors, as well as the appointment of insolvency practitioners allied to the company's management. See further McCormack (n 88).

[96] See for example, S Frisby, 'A Preliminary Analysis of Pre-packaged Administrations (Report to The Association of Business Recovery Professionals)' (August 2007) <http://www.r3.org.uk/media/documents/publications/press/preliminary_analysis_of_pre-packed_administrations.pdf > (accessed 26 August 2013); P Walton, 'When is Pre-Packaged Administration Appropriate? – A Theoretical Consideration' (2011) 20 *Nottingham Law Journal* 1 and references cited at n 7 therein; V Finch, 'Pre-Packaged Administrations and the Construction of Propriety' (2011) 11 *Journal of Corporate Law Studies* 1; R Parry, 'Is UK Insolvency Law Failing Struggling Companies?' (2009) 18 *Nottingham Law Journal* 42, 45-47 and references cited at n13 therein.

[97] There is no obligation for administrators to report pre-packs as such, but there is a growth in the number of administrations in general: see The Insolvency Service, 'Report on the First Six Months' Operation of Statement of Insolvency Practice 16', July 2009, [2.3].

appointment".[98] The pre-pack, as a sale of the company's business rather than a continuation of the existing company, is not a rescue as such, and therefore must be justified by the administrator.[99] This is especially significant where not rescuing the company would result in a better return to creditors as a whole.

Whether the objectives of a pre-pack administration are achieved is discussed elsewhere.[100] Undoubtedly, the preservation of the company's business has the capacity to save jobs and goodwill,[101] and the more rapidly this is done, the better the outcome may be for creditors. The administration is speedily completed as unsecured creditors lack participation in the process,[102] and they are presented with a "fait accompli". However, it is difficult to ensure that best price is obtained where there is a lack of competition in the sale of the business, and there is a risk that the sale of the company's business to those associated with the company previously may facilitate fraudulent phoenix activity.[103] Thus, while the speed of the procedure might maximise its benefits, it contributes to a lack of transparency[104] that engenders suspicions of unfair dealings.[105] As a result of this concern, the standards applicable to sales under a pre-packaged administration sales were strengthen in January 2009 through SIP 16, which requires greater disclosure by the insolvency practitioner.[106] The

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[98] The Institute of Chartered Accountants in England and Wales, 'Statement of Insolvency Practice 16: Pre-packaged Sales in Administrations England and Wales' (January 2009) (SIP 16) <http://www.icaew.com/~/media/Files/Technical/Insolvency/regulations-and-standards/sips/england/sip-16-e-and-w-pre-packaged-sales-in-administrations.pdf> (accessed 26 August 2013).

[99] According to Insolvency Act 1986 (UK), Schedule B1 [3](3), 'The administrator must perform his functions with the objective specified in sub-paragraph (1)(a) unless he thinks either— (a)that it is not reasonably practicable to achieve that objective, or (b)that the objective specified in sub-paragraph (1)(b) would achieve a better result for the company's creditors as a whole.'

[100] See for example, Frisby, 'Preliminary Analysis' (n 96); S Frisby, 'The Pre-pack Progression: Latest Empirical Findings' (2008) 21 *Insolvency Intelligence* 154; S Frisby, 'The Second Chance Culture and Beyond: Some Observations on the Pre-pack Contribution' (2009) 3 *Law and Financial Markets Review* 242; V Finch, 'Pre-packaged administrations' , in V Finch, *Corporate Insolvency Law: Perspectives and Principles,* (2nd ed, CUP 2009); Walton, 'When is Pre-Packaged Administration Appropriate?' (n 96); V Finch, 'Corporate Rescue Processes: the Search for Quality and the Capacity to Resolve' (2010) 6 *Journal of Business Law* 502. See further Bo Xie, 'The Role of Insolvency Practitioners in the UK Pre-pack Administrations – Challenges and Control' (2012) 21 *International Insolvency Review* 85; Bo Xie, 'Regulating Pre-packaged Administration - A complete Agenda' (2011) 5 *Journal of Business Law* 513.

[101] The Insolvency Service, 'Enterprise Act 2002 - Corporate Insolvency Provisions: Evaluation Report' (January 2008), at 147.

[102] Therefore, pre-packs are not consistent with the Cork Report, for example, at [914], [917] and [919] where the Report hoped for a more active role for ordinary creditors in insolvency proceedings. However, in defence of the appointment of receivers, the Cork Report did acknowledge the capacity of the receiver to quickly dispose of the business as a going concern, to the benefit of 'the employees, the commercial community, and the general public'. Cork Report (n 2) [495].

[103] See Finch, 'Construction of Propriety' (n 96) 5.

[104] See V Finch, 'Corporate Rescue: Who is Interested?' (2012) 3 *Journal of Business Law* 190, 199. Information comes belatedly, not for the process of agreeing the rescue proposal but rather for holding the insolvency practitioner to account for any impropriety. See below n 106.

[105] See for example, Parry (n 96) 45; Finch (n 96) 6; for judicial recognition of possible problems with pre-packs, see *Re Kayley Vending Limited* [2009] EWHC 904 (Ch); [2009] BCC 578, 583. While secured creditors recover more in a pre-pack compared to a business sale (42% to 28% respectively) unsecured creditors fare worse in a pre-pack, recovering in average 1% of their debts, compared to 3% in standard business sales: Frisby, 'Preliminary Analysis' (n 96) 53, 56.

[106] SIP 16 (n 98) [9], lists specific required disclosures, including details of the engagement of the insolvency practitioner, prior work done for the company, alternative proposals considered, consultations with major creditors and valuations taken of the business, for the purpose of explaining to creditors why the pre-pack was recommended. However, the information is of limited usefulness to creditors as it is given after the prepack is completed.

Labour Government announced in March 2010 that it would be taking steps to improve the transparency and confidence of pre-packs, but following consultation with interested parties,[107] the Conservative Government concluded in January 2012 that it was "not convinced that the benefits of new legislative controls presently outweighs the overall benefit to business of adhering to the moratorium on regulations affecting micro-business which is an important plank of this Government's deregulatory agenda".[108] Nonetheless, on 12 March, 2013, the Insolvency Service revealed that that "the Government has announced an independent review into pre-pack administration during a Parliamentary debate on pre-packs".[109] This may reflect growing concerns with the procedure.

The UK's principal provision to address fraudulent phoenix activity is activated where the new company uses a similar name to the defunct company. The Cork Report was the origin of s 216 of the Insolvency Act 1986, as the report had noted that "[t]he dissatisfaction is greatest where the director of an insolvent company has set up business again, using a similar name for the new company, and trades with assets purchased at a discount from the liquidator of the old company."[110] However, the Cork Report had not recommended the "similar name" qualification. Its recommendation[111] was much broader, imposing liability for the debts of a second company where a person had taken part in the management of one company, any time during 2 years prior to its insolvency, where they then take part in the management of a second company which commences or continues trading within 12 months of the insolvent liquidation of the first company and where second company itself goes into insolvent liquidation within three years of the insolvency of the first company.[112]

In contrast, s 216 applies to those who were directors of the first company within 12 months prior to its insolvent liquidation. Without leave of the court or unless other prescribed circumstances apply,[113] the person is prohibited from being a director of another company with the same or similar name as the first within 5 years of the first company's liquidation. Breach of the prohibition attracts a term of imprisonment or a fine.[114] As a strict liability offence, there is no requirement for a fraudulent intention or bad faith.[115] Personal liability for the debts of the second company is imposed by s 217, and action may be brought by individual debtors. The objective of s 216 was to protect creditors from being duped into believing that they were still trading with the same company. However, the section has been

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[107] The Insolvency Service, 'Improving the Transparency of, and Confidence in, Pre-Packaged Sales in Administration: Summary of Consultation Responses' (March 2011).

[108] The Rt Hon Edward Davey, 'Pre-packaged Sales in Insolvency', Written Ministerial Statement, 26 January, 2012.

[109] See The Insolvency Service, 'Review of Pre-packs' < http://www.bis.gov.uk/insolvency/news/news-stories/2013/Mar/PrePackStatement> (accessed 26 August 2013).

[110] Cork Report (n 2) [1813].

[111] ibid [1827].

[112] Paragraph 1834 recommended that the liability not be imposed in relation to a company with a paid up share capital of £50,000 or which is a wholly owned subsidiary of a company with a paid up capital of that amount.

[113] Insolvency rule IR4.228 provides an exception where the successor company acquires the whole or substantially the whole of the business of the insolvent company under arrangements made by the insolvency administrator as liquidator, administrator or receiver. Under this procedure, the successor company must give notice in the prescribed form to all the company's creditors within 28 days of the completion of the transaction. In addition, the rule requires that notice be published in the Government Gazette. Another exception is IR4.230, where the successor company has been known by the similar name for the whole of the 12 month period prior to the liquidation of the failed company. Note that this does not apply when the successor company has been dormant.

[114] Insolvency Act 1986, s 216(4).

[115] *Ricketts v Ad Valorem Factors Ltd* [2004] 1 All ER 894.

interpreted more widely than that.[116] Nonetheless, despite this broader interpretation, the section is of no use in tackling fraudulent phoenix activity where an entirely different name is chosen.

To target delinquent directors who engage in fraudulent phoenix activity without[117] contravening the requirements of s 216, action must be taken[118] pursuant to the general director disqualification provisions of the Company Directors Disqualification Act 1986 (UK) (CDDA).[119] Section 6 requires the court to disqualify a person who is or has been a director of a company that becomes insolvent, where "his conduct as a director of that company (either taken alone or taken together with his conduct as a director of any other company or companies) makes him unfit to be concerned in the management of a company." In addition, the court may disqualify a director on the application of the Secretary of State in similar circumstances.[120] Unfit conduct is defined in Schedule One of the Act and includes any misfeasance or breach of duty.[121] According to *Re Stanford Services Ltd*

> ...the public is entitled to be protected, not only against the activities of those guilty of the more obvious breaches of commercial morality, but also against someone who has shown in his conduct of a company a failure to appreciate or observe the duties attendant on the privilege of conducting business with the protection of limited liability.[122]

In the UK, common law and equitable directors' duties were codified in Part 10, Chapter 2 of the Companies Act 2006, but while they replace the former rules,[123] they are still interpreted and applied as before,[124] and the consequences are the same.[125] Thus, the company itself is the proper plaintiff to bring an action against a director in breach, or the company's shareholders may sue on the company's behalf via a statutory derivative action.[126] Where a company is insolvent and the breach involves fraudulent phoenix activity, shareholders are unlikely to act and the company's liquidator may be reluctant to initiate action. In the UK, there is no agency charged with the responsibility for enforcing directors' duties. Instead, it appears that the director disqualification regime plays the enforcement role.

The director disqualification regime has been used often by the Insolvency Service.[127] This is beneficial in removing errant directors but fails to provide any remedy for the company or the

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[116] The cases are discussed as part of the commentary in Section E below.
[117] Note that liability under s 216 can also be grounds for disqualification. See *Re Travel Mondial (UK) Ltd* [1991] BCLC 120,123; also *Re Saver Ltd* [1999] BCC 221; see further Griffin (n 24) 380 at n 12.
[118] Proceedings are brought by the Insolvency Service. Information forming the basis of the application may come from insolvency practitioners. Company Directors Disqualification Act 1986 (CDDA), s 7(3) and (4).
[119] See Wilson (n 92) 155-6, where the author discusses the 'name and shame' campaign against directors of phoenix companies where a different name for the new company is chosen, and where the CDDA provisions must therefore be used. See further G Wilson, 'Delinquent Directors and Company Names: the Role of Judicial Policy-Making in the Business Environment' (1996) 47 *Northern Ireland Legal Quarterly* 345. Bradley notes that '[o]ne of the main objectives of the [CDDA] was to deal with the 'Phoenix' problem.' Bradley (n 88) 65.
[120] CDDA, s 8 provides for director disqualification where the court 'is satisfied that [the director's] conduct in relation to the company makes him unfit to be concerned in the management of a company.'
[121] CDDA, Schedule One, s 1.
[122] (1987) 3 BCC 326, 334 per Vinelott J.
[123] Companies Act 2006, s 170(3).
[124] ibid s 170(4).
[125] ibid s 178.
[126] ibid Part 11.
[127] Insolvency Service, 'Enforcement and Investigation News' (October 2012). <http://www.bis.gov.uk/assets/insolvency/docs/ies/enforcement-news-final.doc> (accessed 26 August 2013), at 6. However, the report does not specify how many of these relate to phoenix conduct.

creditors who were the victims of the phoenix conduct. A register of disqualified directors is kept by Companies House,[128] and while it may be searched free of charge, the register is of relatively little use to potential company creditors trying to avoid a phoenix operator. A creditor is not always aware of directors' names when doing business with a company, nor may they be aware that there are issues relating to the non-payment of debts in other companies with which the director has been associated. Most unsecured creditors do not want the cost or time commitment associated with undertaking company searches and other due diligence enquiries. The register is most useful once the creditor "smells a rat", and if that occurs, checking the register of disqualified directors is but one of many actions that a cautious creditor should take.[129]

In 2001, the Final Report of the Company Law Steering Group noted that there are few cases dealing directly with phoenix companies, as liquidators frequently bring actions with respect to fraudulent or wrongful trading, misfeasance, preferences or transactions at an undervalue, as a means of recovery for the benefit of creditors.[130] The fraudulent trading provisions[131] appear to be particularly suited to fraudulent phoenix activity. Section 213 provides for persons knowingly involved in business carried on with a fraudulent intent or purpose to be liable to make contributions to the company's assets as the court thinks proper. However, fraud is a strong word,[132] and according to Finch, its proof in the civil context "has led to the ... section's virtual obsolescence".[133] Another obstacle to the section's usefulness civilly is that it relies on the liquidator bringing the action. Any action by a liquidator is subject to a careful reckoning of the potential costs of the litigation and the likelihood of its success, given that scarce assets otherwise available for distribution to creditors will be consumed by the litigation. The fraud offences[134] overcome this latter issue but as criminal offences require proof beyond reasonable doubt.[135] This provides a substantial hurdle to be overcome by prosecutors and may result in proceedings only being brought in the most obvious cases.

There are a range of other actions available to liquidators. In relation to wrongful trading,[136] liquidators may apply to the court to have a director declared personally liable to make such contribution to the company's assets as the court thinks proper, where the director knew or

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[128] The Secretary of State must maintain a register under section 18 of the CDDA. Companies House performs this function under delegated authority for the Secretary of State. The information for the register comes from the courts and from the Insolvency Service. See Companies House, 'Disqualified Directors Register FAQs' <http://www.companieshouse.gov.uk/infoAndGuide/faq/ddr.shtml> (accessed 26 August 2013).
[129] Note also on a theoretical level, R Williams, 'Disqualifying Directors: A Remedy Worse than the Disease?' (2007) 7 *Journal of Corporate Law Studies* 213, who argues that disqualification is not an effective way in which to reduce agency costs from conflicts of interest between corporate agencies because of a failure of private bargaining.
[130] Department of Trade and Industry, *Modern Company Law for a Competitive Economy: Final Report* (London, 2001), [15.61].
[131] See further Finch, 'Corporate Insolvency Law'(n 100) 696-8.
[132] This same objection can be raised with respect to Insolvency Act 1986, s 206 'Fraud etc in anticipation of winding up' and s 207 'Transactions in fraud of creditors'.
[133] Finch, 'Corporate Insolvency Law' (n 100) 697.
[134] Note also s 993(1) of the Companies Act 2006, which provides that 'If any business of a company is carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, every person who is knowingly a party to the carrying on of the business in that manner commits an offence'.
[135] However, under sections 206 and 207 of the Insolvency Act 1986, the onus of disproving an intention to defraud is placed on the accused company officer, rather than the onus of proving intention to defraud being on the prosecution: s 206(4)(a) and s 207(2)(b) respectively.
[136] Insolvency Act 1986, s 214.

ought to have known of the company's insolvency. Defences are available.[137] Liquidators may also sue in relation to voidable transactions. Section 238 of the Insolvency Act 1986 allows a liquidator to apply to court for an order in relation to transactions at an undervalue.[138] An order cannot be made if the company entered the transaction in good faith and "for the purpose of carrying on its business", so it would appear to be available in cases involving phoenix transactions where by definition, the business of the failing company is discontinued. Preferences to creditors can be recovered under s 239.

Thus it can be seen that the UK, like Australia, has a range of provisions that are available to deal with phoenix behaviour, with some better suited to the task than others. Whether any should be adopted in the Australian context will be explored in the next Section.

E. COMPARISON AND ANALYSIS

The preceding two Sections have shown some similarities, at least superficially, between the regimes in Australia and the UK for dealing with fraudulent phoenix activity. This Section will now compare the provisions and consider whether either nation has succeeded in creating a regulatory climate where fraudulent phoenixing is deterred.

1. Rescue culture

In the UK, the rescue culture is more overt and deliberate than in Australia. The UK Government actively seeks ways of encouraging viable insolvent companies to remain in business.[139] In contrast in Australia, there are no express interventions of this kind by the Government. However, the provision allowing for entry into voluntary administration (VA) speaks of the prime objective being "for the business, property and affairs of an insolvent company to be administered in a way that ...: (a) maximises the chances of the company, or as much as possible of its business, continuing in existence;".[140] Only if the company or its business cannot continue in business is the VA to attempt to improve the return to creditors and shareholders compared to what they would receive in a liquidation.[141]Thus, Australia does not differentiate the saving of the company from the saving of the business as the UK does, nor does the insolvency practitioner have any obligation to explain why the business was sold rather than the company being saved. This might appear to facilitate fraudulent phoenix activity because no attempt needs to be made to save the company.

However, it is arguable that neither the UK's overt rescue culture, nor Australia's VA procedure, are the causes of fraudulent phoenix activity. Rather, it flourishes because phoenix operators believe they will avoid detection and prosecution where they have acted improperly. In other words, greed trumps fear. A rescue culture may therefore provide a shield for phoenix operations to hide behind, particularly through the open endorsement of pre-packs, but it is neither a necessary nor sufficient condition for fraudulent phoenix activity

[137] ibid s 214(3).
[138] Different rules apply to Scotland: Insolvency Act 1986, s 242 (gratuitous alienations) and s 243(unfair preferences).
[139] For example, see Insolvency Service, 'Support for the rescue of viable insolvent businesses', Press release, (26 February 2013), announcing Government plans to legislate to compel essential service providers to continue to supply insolvent businesses, so that the insolvency practitioner has the best opportunity to save the business.
[140] Corporations Act 2001, s 435A.
[141] ibid s 435A(b).

to thrive. This is demonstrated in Australia by the reality that despite the decline in the popularity of rescue-orientated VAs and significant legislative hurdles to pre-pack administrations,[142] phoenixing through liquidated or deregistered companies continues to be a significant, and some say, a growing, problem.

The fact remains that phoenixing exists outside the "rescue culture" scenario. As the 2009 Phoenix Proposals Paper in Australia showed, "sophisticated" phoenix activity occurs within corporate groups, where the phoenix company has been incorporated well before the insolvent company is liquidated. This behaviour is not captured by the UK similar names legislation and there seems comparatively little recognition in the UK of the phoenixing issue within corporate groups.[143]

From an outsider's perspective, it appears that the deterrence of phoenix activity in the UK is not a high priority. While scholars and commentators note the prevalence of phoenixing and the scope for abuse of insolvent administrations through prepacks, such remarks are rebutted by "big picture" statements about the importance of the rescue culture to the economy. There is no reliable estimate as to the size of the problem. The damage it causes, and whether that damage is outweighed by the benefits of the rescue culture, therefore remain matters of conjecture. These, in turn, obscure any reliable reckoning as to whether there is adequate enforcement of the anti-phoenixing provisions. In Australia, shining a light on fraudulent phoenix activity has led to growing concern, but this has not been matched by an easy estimation of the size of the problem, or more importantly, readily apparent solutions. There is a sense that its laws are insufficient to deal with phoenixing, or that the enforcement of existing laws are inadequate, but there is no clear path ahead. Before dealing with the broad question of enforcement, the provisions in the UK and Australia will be compared and contrasted.

2. Similar names legislation

As noted above, the UK has had similar names legislation since 1986. In Australia, this type of provision was mooted in 2012[144] but attracted no support. As a result, the draft Bill was not introduced into Parliament by the Government.

That appears to have been a wise decision. There are acknowledged limitations to s 216 of the Insolvency Act,[145] including the obvious one of only applying where the phoenix

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[142] E Poulos and A McCunn, 'Pre-pack Transactions in Australia' (2011) 19 *Insolvency Law Journal* 235; H Lloyd, M O'Brien and J Robertson, 'Pre-packaged Transactions in Administration – Strategy and Application' (2009) 9 *Insolvency Law Bulletin* 110; N Crouch and S Amirbeaggi, 'Pre-packs: a Legitimate Means to Phoenix an Insolvent Company' (2011) 23 *Australian Insolvency Journal* 30; M Wellard, 'UK Pre-pack Reforms' (2011) 23 *Australian Insolvency Journal* 12; M Wellard and P Walton, 'A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means be Made to Justify the Ends?' (2012) 21 *International Insolvency Review* 143.

[143] That said, the problems created for creditors by corporate groups are well recognised. See for example, Cork Report (n 2) Chapter 51, also [1934] and [1950] where the laws dealing protecting group creditors were described as 'undoubtedly a defective law' and 'seriously inadequate' respectively; D Milman, 'Groups of Companies: The Path towards Discrete Regulation' in D Milman (ed), *Regulating Enterprise: : law and business organisations in the UK* (Hart Publications, 1999) 219; Finch, *Corporate Insolvency Law* (n 100) 581 – 598 and references cited therein.

[144] The Parliament of the Commonwealth of Australia, Exposure Draft, Corporations Amendment (Similar Names) Bill 2012, (20 December 2011) <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2011/Corporations-Amendment-Similar-Names-Bill-2012> (accessed 26 August 2013).

company has a similar name to the insolvent company. The UK courts have widened the scope of the application of the section, applying it where the same business is conducted by the same people in the same location, even if only one word of the name is the same.[146] There is no requirement to prove that the creditors of the phoenix company were confused by the two names,[147]and the section gives the court no discretion to ensure that it is only used to punish phoenix activity.[148] Simon Brown LJ noted the "the surprisingly long reach of this legislation" in *Ricketts v Ad Valorem Factors Ltd*,[149] where the court was obliged to find a breach of the section even where the director had not been responsible for the insolvent company's demise, no assets had been transferred between the old and new companies, and some efforts had been made to change the company's name to avoid confusion.[150] Arguably, the provision recommended by the Cork Report[151] would have avoided some of these difficulties and more accurately captured the intended behaviour.

These interpretations mean that the legislation appears to interfere in business rescues beyond its intended role. In genuine business rescues, where the directors are trying to get the business back on its feet using as much goodwill, property and expertise from the old company as possible, the directors are obliged to seek the court's dispensation under s 216(3). This additional cost and effort comes at the worst possible time for the directors who are scrambling to save the business. On the other hand, deliberately fraudulent phoenix operators who may have stripped the insolvent company of assets and left it without any goodwill to salvage are free to establish a new company with a different name and location without hindrance. Indeed, where a company has become notorious in an industry for non-payment of its creditors, its former directors may be compelled to start its successor under a completely different name to enable it to obtain supply of goods and services. In addition, the provision only captures liquidated companies and not those who are in another form of administration or are simply deregistered.[152]

In Australia, the Similar Names Bill adopted an identical "same or similar name" requirement as well as the time limits of the UK provision.[153] Like s 216, the Similar Names Bill did nothing to prevent 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 an associate, spouse, son or daughter, is appointed director instead. The issue of phoenixing within

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145 Griffin, for example, calls it 'an unmitigated failure': Griffin (n 24) 388. The Final Report of the Company Law Steering Group recommended a reform of the 'transactions at an undervalue' provisions, Griffin (n 24) [15.66] – [15.70].

146 See for example, *First Independent Factors & Finance Ltd v Mountford* [2008] EWHC 835 (Ch); [2008] BCC 598 ('Classic Conservatories and Windows' and 'Classic Roofs Ltd'); *Commissioners of HM Revenue & Customs v Benton-Diggins* [2006] EWHC 793 (Ch); [2006] BCC 769 ('Williams Hair Studio Ltd' and 'Williams and Xpress Ltd'. See further C Werner, 'Phoenixing – Avoiding the Ashes' (2009) 22 *Insolvency Intelligence* 105, 106.

147 *Commissioners of HM Revenue & Customs v Walsh* [2005] EWHC 1304 (Ch); [2005] 2 BCLC 455.

148 *Thorne v Silverleaf* [1994] 2 BCLC 637, 642 (Ralph Gibson LJ).

149 *Ad Valorem Factors Ltd v Ricketts* [2004] 1 All ER 894, [24].

150 See *Ad Valorem Factors Ltd v Ricketts v* [2004] 1 All ER 894,[18], where Mummery LJ said: "the legal position is that, if the name of Air Equipment is a prohibited name within the natural and ordinary meaning of the language of s216(2), this case is caught by the restrictions, even if this is not a 'Phoenix Syndrome' case and even if the sanctions of criminal liability seem to be harsh."

151 Cork Report (n 2) [1813] and accompanying text.

152 See D Milman, 'Curbing the Phoenix Syndrome' [1997] *Journal of Business Law* 224, 228.

153 Corporations Amendment (Similar Names) Bill 2012, s 596AJ.

corporate groups was also not addressed.[154] As with its UK exemplar, the Bill only applied to companies in liquidation, and therefore did not capture companies placed into administration and then deregistered. However, the Bill confined its reach to civil liability, [155] rather than the UK's civil and criminal liability.[156] This reflects the accepted Australian position that criminal liability allowing for imprisonment should only be available for offences involving dishonesty or recklessness. A compromise could have been the Australian hybrid, the "civil penalty" provision,[157] which empowers a court to disqualify a director, impose a pecuniary penalty or order compensation for the company.[158]

The Bill's drafters appear to have learnt something from the body of case law in the UK that deals with s 216. In relation to court approval, dispensation could be given prospectively or retrospectively.[159] In addition, in granting relief from liability, the court would be obliged to take into account, inter alia, the extent to which the phoenix company owned the assets of its insolvent predecessor and the expectation of solvency within the phoenix company at the time of incurring its debts.[160] Presumably to reduce the costs of a court application, the phoenix company's liquidator would also be given the power to exempt the director from liability,[161] although the wisdom of this provision is debateable, as liquidator dispensation could give rise to allegations of collusion between the two. Apparently to avoid the outcome of *Ricketts*, an exception to liability was provided where the first company had paid its debts in full.[162]

These sorts of provisions are all useful templates for UK legislators to consider in any revision of s 216. In any event, both countries need to identify exactly what is at issue in a new company using a name similar to that of a previously failed company. The impetus behind these sections is the desire to protect new creditors from being fooled into thinking that the same business is ongoing. This, presumably, is to protect them from extending credit that may not be repaid. However, other creditors of the first business were in the same situation with the earlier entity, thanks to the doctrine of limited liability. The creditors of the second company are in no worse a position than those of the first. What appears to make the situation contemptible is the fact that the same people are running the phoenix company using assets from the failed company, assumed to have been purchased at below market prices through a secret deal. It is this perceived fraud that is objectionable. However, this situation is already dealt with through laws in both the UK and Australia that govern transactions at an undervalue[163] and company contracts with related parties.[164] These are the dealings that

[154] In the UK, an exception to liability exists where the successor company has been known by its prohibited name for the whole of the 12 month period prior to the liquidation of the failed company. (Regulation 4.230). This would frequently be the situation for related companies within corporate groups. The UK legislation thus provides no impediment to phoenix activity within groups. The Australian version made no attempt to deal with group phoenixing.
[155] Corporations Amendment (Similar Names) Bill 2012, s 596AJ(1).
[156] Insolvency Act 1986, s 217(1) and s 216(4) respectively.
[157] Corporations Act 2001 (Aust), Part 9.4B.
[158] ibid s 206C, s 1317G and s 1317H respectively.
[159] ibid s 596AK(1).
[160] ibid s 596AK(4).
[161] ibid s 596AL.
[162] ibid s 596AN.
[163] Corporations Act 2001, Part 5.7B; Insolvency Act 1986, s 238.
[164] In Australia, see the directors duties in the Corporations Act Part 2D.1 and the related party transaction restrictions for public companies in Part 2E.1; in the UK, see Companies Act, s 175 for the directors' duty to avoid conflicts of interest and s176 for the duty not to accept benefits from third parties; also s218 Payment in connection with transfer of undertaking etc: requirement of members' approval.

should be impugned, rather than the establishment of the new company with the same or a similar name.

A more general sense behind similar names laws is the fact that the directors have “form” in terms of being in control of a company that has liquidated without paying its debts, and that creditors of the second company should be warned against, or protected from, these sorts of people because they are trying to hoodwink their creditors. This is fuzzy thinking. There is no prohibition against being a director of a failed business. Indeed the rhetoric is often that previous business failure breeds the experience that leads to later business success. The ease with which similar names legislation can be side-stepped, and the difficulties created for those genuinely trying to save the business of a failed company by capitalising on existing goodwill, indicate that Australia was correct in abandoning its draft laws in this area. For a country with an express rescue culture such as the UK, s 216 appears to impose an unfortunate hurdle for legitimate business resurrections.

3. Directors’ Duties, Wrongful Trading and Voidable Transactions

In both the UK and Australia, these types of actions have not proven to be strong weapons against fraudulent phoenix activity. Enforcement is particularly problematic in relation to directors’ duties, and it is noteworthy for those in the UK that the existence of a regulator in Australia with power to bring both criminal and civil penalty actions for directors’ duty breaches has not resulted in a significant number of actions. Constraints on enforcement are considered below.

It is unclear why wrongful trading actions in the UK are not better utilised in the fight against phoenixing,[165] as its provisions are broader than Australian insolvent trading.[166] As in the case of all actions by liquidators, UK liquidators may be reluctant to spend scarce resources in actions with limited chances of success, and the more a company is stripped of its assets, the less money is available to pursue directors for wrongful trading or for the recovery of transactions at an undervalue. The Australian insolvent trading provision has a number of limitations that reduce its effectiveness for use against phoenix activity. As noted above, the main one is that the provision only captures uncommercial transactions which take place when the company is actually insolvent – unable to pay its debts when they fall due - and the evidentiary burden of establishing the inability to pay debts at the time of the transaction remains significant. As noted in the introduction to this article, a Government suggestion in 2010 of a “safe harbour” against insolvent trading actions did not proceed.[167] It appears that neither countries’ provisions in relation to insolvent or wrongful trading are appropriate to deal adequately with fraudulent phoenix activity.

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[165] Finch notes that wrongful trading has proved to be a disappointment in terms of the number of decided cases: Finch, ‘Corporate Insolvency Law’(n 100) at 700.

[166] While the Australian law speaks of ‘suspecting insolvency’, in comparison with the British ‘reasonable prospects’, the Australian provision requires the company to be insolvent at the time of the transaction or become insolvent as a result of it. See further J Payne and D Prentice, ‘Civil Liability of Directors for Company Debts under English Law’ in I Ramsay (ed), ‘*Company Directors Liability for Insolvent Trading*’ (Centre for Corporate Law and Securities Regulation, Faculty of Law, University of Melbourne; CCH Australia, 2000) 190, 199-202.

[167] See Australian Government, Treasury (n 20) and accompanying text. In the Foreword to that paper, the Hon Chris Bowen said “Concerns have been raised that the laws directed at preventing businesses from trading while insolvent may negatively impact on genuine work-out attempts; in particular, where restrictions on the availability of credit impede the ability of businesses to temporarily maintain solvency while work-outs are attempted.” at (v).

4. Disqualification

Both countries have disqualification regimes that facilitate the removal of the director from the marketplace for the protection of future creditors.[168] In the UK, disqualifications are based on information which must be provided to the Secretary of State by insolvency practitioners concerned with receiverships, administrations or insolvent liquidations, (but not company voluntary administrations)[169] and a report on the conduct of every director must be made within six months of appointment.[170] One shortcoming of the UK regime recognised by the Cork Committee was the requirement for a court order,[171] rather than disqualification being automatic in defined circumstances. Public enforcement is necessarily dependent on the regulator having both the required information on which to base the action and the required resources to make application to the court, and the director's disqualification can only be ordered once the matter reaches the court. These hurdles and delays necessarily limit the effectiveness of the regime. To overcome this, in 2000 the CDDA was amended to allow for directors to enter into disqualification undertakings voluntarily.[172]

As noted in Section C, in Australia, ASIC may[173] itself disqualify directors for up to five years for being associated with two or more failed companies in the past seven years, where their behaviour contributed to the company's insolvency,[174] whereas a court application would allow for disqualification for up to 20 years.[175] While it might seem that allowing a regulator to disqualify a director without court approval is a worthwhile consideration for the UK, some limitations should be made clear. First, only the most egregious cases attract the full five years.[176] This means the perpetrator is able to begin another company in a relatively short period of time. Second, while the disqualification covers all forms of directorship – de jure, de facto and shadow – it is difficult for ASIC to detect if the disqualified director runs a further phoenix company using a family member as its director.[177] Third, the ASIC power to disqualify is based on receiving information from a liquidator's report[178] and therefore is not useful with regard to fraudulent phoenix activity in VAs or companies that are simply deregistered or remain dormant.

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[168] See Bradley (n 88) 65 and footnote 85.
[169] 'Report under Section 7(3) of the Company Directors Disqualification Act 1986', UK Statutory Instrument no 764, The Insolvent Companies (Reports on Conduct of Directors)(Amendment) Rules 2001.
[170] 'Return By Office-Holder Under Rule 4 Of The Insolvent Companies (Reports On Conduct Of Directors) Rules 1996' contained in UK Statutory Instrument no 764, The Insolvent Companies (Reports on Conduct of Directors)(Amendment) Rules 2001.
[171] Cork Report (n 2) [1826].
[172] CDDA, s 1A.
[173] Disqualification under s 6 of the CDDA is mandatory, whereas in Australia, both ASIC and the court's powers are permissive.
[174] Corporations Act 2001 (Aust), s 206F.
[175] ibid s 206D.
[176] For examples of ASIC's use of this disqualification power, see Australian Securities & Investments Commission, '10-172AD ASIC disqualifies 13 directors of failed companies from managing corporations' <http://www.asic.gov.au/asic/asic.nsf/byheadline/10-172AD+ASIC+disqualifies+13+directors+of+failed+companies+from+managing+corporations?openDocument> (accessed 28 August 2013).
[177] In 2005, James Soong was banned by ASIC from managing companies for four years over his role in five construction companies that collapsed within seven years leaving creditors with less than 50 cents in the dollar. The history of the group's phoenixing was set out as a case example by the Cole Royal Commission: volume 8, chapter 12 (n 26) [45] – [53]. In 2005, James Soong's wife Desley replaced him on the board of 10 companies, and has been on the boards of at least five companies that have been placed into external administration since then. See A Ferguson, 'The Phoenix Dilemma', *The Age* (Melbourne, 11 December 2010) 1.
[178] Corporations Act 2001 (Aust), s 206F(1)(ii). The liquidator's report is provided under s 533 of the Act.

Companies can be deregistered voluntarily or compulsorily for failure to lodge required documents and pay annual fees. It is the latter category that is of particular concern. A 1996 report by ASIC's predecessor had found that the vast majority of phoenix companies were deregistered rather than liquidated.[179] As a result, the present deregistration provisions of the Corporations Act[180] vest ASIC with the property of the company[181] and give it the powers of the company or a liquidator in satisfying the company's liabilities.[182] However, there is no data available from ASIC to determine whether ASIC exercises these liquidator powers to pursue the directors of compulsorily deregistered companies for phoenix behaviour. Even the number of companies deregistered each year is no longer published.[183]

Thus, while the disqualification provisions of both countries are the main means by which phoenix operators are removed from business, neither is without limitations. The general deterrence effect of these provisions are questionable, given that disqualifications receive little publicity outside of regulator bulletins.

5. Dormant companies and the Phoenixing Act

Australia's new Phoenixing Act, in providing ASIC with an administrative power to order the winding up of a dormant or deregistered company, appears to shift at least some of the responsibility for detecting and prosecuting phoenix activity from ASIC to a liquidator. This seems desirable if the appointment of liquidators can overcome some of the limitations of public enforcement. That said, where the deregistered companies are without assets, it is unlikely that liquidators will be willing to accept these appointments.

It appears that the Phoenixing Act will have little positive benefit for those affected by the conduct it supposedly targets. The regulatory guide that explains the Act's implementation[184] makes it clear that ASIC intends to exercise its power to wind up abandoned companies only in very limited circumstances.[185] ASIC will wait at least 6 months before winding up a dormant company, to see whether a creditor comes forward to do so. This delay can only work against the recovery of assets for the benefit of creditors. ASIC will not take action where the expected costs of the liquidation ($15,000) exceeds the amount of unpaid wages. On the other hand, no action will be taken where the amount owing is "substantial" enough to

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[179] D Barlow, National Intelligence and Analytical Service, *Project One: Phoenix Activities and Insolvent Trading* (Australian Securities Commission Research Paper 95/01, 1996), 75. The Australian Securities Commission is the predecessor of the current Australian Securities and Investments Commission. The paper found that 'it would appear that approximately 92% of Phoenix companies are deregistered under the ASC's section 574 program. Effectively the ASC is unintentionally assisting Phoenix offenders to escape prosecution and detection by deregistering the company and closing off the trail. This is particularly the case in circumstances where debts may be many, but small and no creditor action is taken to place the company under administration.'

[180] The section has been substantially re-written from the Corporations Law version. This was in part as a result of the recommendation of the Australian Securities Commission, ibid 75, which recommended that 'a detailed examination of the s 574 program's objectives and outcomes be undertaken with a view to addressing phoenix activity'.

[181] Corporations Act, s 601AE.

[182] ibid s 601AF.

[183] In 2007-2008, the number was 23,565, significantly higher than the number of companies placed into a form of external administration. ASIC *Annual Report, 2007 – 2008* (ASIC 2008) 57.

[184] ASIC, *ASIC's Power to Wind Up Abandoned Companies* (Regulatory Guide 242, January 2013), [RG242.11] – [RG 242.12].

[185] ibid Part B.

justify the employees taking action to liquidate the company themselves.[186] It is therefore unclear in what circumstances ASIC proposes to exercise its new powers. The guide also indicates that ASIC will not re-register a deregistered company for the purpose of it being wound up and having its affairs examined by a liquidator.[187] It seems therefore, after much hand-wringing and ambitious pronouncements from the Government, that relatively little has been achieved in the deterrence of fraudulent phoenix activity in Australia through its Phoenixing Act, and therefore this is not a model to be emulated.

6. Enforcement Issues

It is self-evident that if behaviour is not characterised as illegal, it will not be prosecuted. In the UK, therefore, the rescue culture and a pervasive sense that a failed business should be given a second chance where possible may lead to an under-characterisation of fraudulent phoenix activity. If the new company side-steps the perils of s 216, and in the absence of an adverse liquidator report that leads to disqualification, its directors can hide any improper dealings behind their rescue bid. The availability of pre-packs may both facilitate the occurrence of phoenixing and aid its concealment. It is possible, therefore, that in the UK, there is under-enforcement of breaches of directors' duties and a failure to disqualify directors who are abusing their positions to benefit their phoenixed companies, but the extent of these breaches does not seem to be a priority for Government. Those pushing for reform in Australia, on the other hand, are keen to make estimates, however unreliable they may be.[188] These estimates lend a sharpness to the calls for increased public enforcement to curb fraudulent phoenix activity.

Enforcement, however, relies on detection. With due respect to individual creditors and trade unions acting on behalf of employees have lost their entitlements, it takes a practiced eye to distinguish fraudulent phoenix activity from the legitimate sale of a failed business to a new company controlled by the same owners. In either case, the purchase price of the assets may be well below their cost due to a scarcity of buyers. The detection burden therefore falls largely on insolvency practitioners. The present form on which insolvency practitioners report to ASIC at the conclusion of an external administration provides the regulator with little useful information. In contrast to the comprehensive detail required in the UK,[189] the report prepared by Australian insolvency practitioners simply requires boxes to be ticked where there are suspicions of illegal conduct and in those cases, where documentary evidence is held. [190] ASIC then asks for more information about 10% of those cases, and a smaller fraction of those are then investigated.[191] No questions are asked about other companies with which the failed company's director is associated. This is not to say that the Insolvency

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[186] ibid Table 1.
[187] ibid.
[188] See for example '*Phoenix Activity: Sizing the Problem and Matching Solutions*' (prepared by PriceWaterhouseCoopers for the Fair Work Ombudsman, June, 2012). They estimated the size between $1.78 billion and $3.19 billion per annum.
[189] See n 169.
[190] *Regulatory Guide 16: External Administrators- Reporting and Lodging* (ASIC Regulatory Guide 16) describes the reports which must be prepared. These are reports of offences, negligence and other misconduct, [RG16.40] and reports of companies where the liquidator may be unable to pay its creditors more than 50 cents in the dollar [RG16.41]. These are reported via Form EX01 Schedule B of Regulatory Guide 16 Report to ASIC under s 422, s 438D or s 533 of the Corporations Act 2001 or for statistical purposes, <http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ex01.pdf/$file/ex01.pdf> (accessed 28 August 2013) .
[191] ASIC, *Insolvency Statistics: External Administrators' Reports 1 July 2011 – 30 June 2012* (ASIC Report 297, September 2012), [44].

Service in the UK follows up every report of director misconduct which becomes apparent from the detailed information provided.[192] Cases in the UK are prioritised as they are in Australia. Some are not investigated and others are investigated and no further action is taken.[193] In Australia, in 2011, 57 staff were cut from ASIC's deterrence team.[194] Given the large volume of suspected breaches of the law reported by insolvency practitioners in the previous year, it seems remarkable that less, rather than more, staff were expected to handle them adequately.[195] Similarly, in the UK, the Insolvency Service has suffered budget cuts.[196] It seems clear that greater public enforcement cannot take place without additional allocations of resources.

In both countries, asset stripping as part of fraudulent phoenix activity has the serendipitous effect of making a company an undesirable liquidation client, and in the absence of a generous government scheme to fund these 'assetless" administrations, these companies will escape scrutiny. Australia has its Assetless Administration Fund (AAF) to fund liquidator investigations. The funding available to the AAF each year is relatively modest, and as noted above, relies on preliminary enquiries by the liquidator who may not be paid for their trouble. The UK has its Official Receiver who has the duty, in the case of compulsory liquidations, to investigate the affairs of the company, and they may make a report to the court.[197]

Occasionally, a creditor is sufficiently well resourced to fund the liquidation or some other action against the directors, and the most common example of this is the revenue authority. In Australia, the Australian Taxation Office has taken action to overturn Deeds of Company Arrangement following VAs,[198] and has had a phoenix company wound up on the just and equitable ground.[199] However, most anti-phoenixing measures undertaken by revenue authorities are to protect their own positions rather than for the benefit of unsecured creditors as a whole. As noted earlier, the DPN regime allows the ATO to impose personal liability on directors for unremitted PAYG taxes and superannuation, and security bonds may be sought from perceived phoenix operators.[200] In the UK, security for payment of PAYE and National Insurance Contributions (NIC) amounts was introduced by s 85 of the Finance Act 2011 (UK).[201] Her Majesty's Revenue and Customs (HMRC) can also impose personal liability

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[192] The liquidator has a duty in all types of liquidation to report any criminal offences apparently committed in relation to the company by any past or present officers or members: Insolvency Act 1986, s 118.
[193] See Insolvency Service, 'Enforcement and Investigation News' (October 2012) 7-8 <http://www.bis.gov.uk/assets/insolvency/docs/ies/enforcement-news-final.doc> (accessed on 30 September 2013)
[194] Senate Economics Legislation Committee, Parliament of Australia, *Estimates*, 31 May 2011, 87. See also B Butler, 'ASIC jobs axed after budget cut', *The Age* (Melbourne, 28 March, 2011) 1; Senate Standing Committee on Economics, Answers to Questions on Notice, Treasury Portfolio, Supplementary Budget Estimates, 20 October, 2011.
[195] The ASIC *Annual Report 2011 – 2012* (ASIC 2012) 14 notes that there are 90 staff performing Misconduct and Breach Reporting functions, receiving and assessing 12,454 reports of misconduct (and finalising 12,515); receiving and assessing 11,404 statutory reports; receiving 1,344 breach reports and assessing 1,363 breach reports; and handling requests to and from foreign regulators (429 received and 251 sent).
[196] See House of Commons, Business Innovation and Skills Committee, 'The Insolvency Service', Sixth Report of Session 2012 – 13, HC 675, [18] noting a loss of one third of Insolvency Service staff, in particular experienced senior staff.
[197] Insolvency Act 1986, s 132(1).
[198] *Deputy Commissioner of Taxation v Woodings* (1994) 13 WAR 189.
[199] *Deputy Commissioner of Taxation v Casualife Furniture International Pty Ltd* (2004) 9 VR 549.
[200] See n 54 and n 55 and accompanying text.
[201] This amended s 684 of Income Tax (Earnings and Pensions) Act 2003 (PAYE regulations). See HM Revenue

notices on directors for unremitted PAYE and NIC, where the failure of the company to pay its liabilities is "attributable to fraud or neglect on the part of one or more individuals who, at the time of the fraud or neglect, were officers" of the company.[202] HMRC may also set a "phoenix signal" on its computer networks to assist with detection and rapid follow up of unpaid tax liabilities.[203] While these measures by both countries' revenue authorities are beneficial to society as a whole, it is worrying that their identification of phoenix operators does not automatically translate into follow-up action by other agencies for the benefit of other unsecured creditors.

F. CONCLUSION

This article has sought to compare the regimes dealing with fraudulent phoenix activity in the UK and Australia, for the purpose of each learning from the other. In the past 4 years, Australia has made a concerted effort to tackle phoenixing, for the good of the economy and the protection of Government revenues. The UK, on the other hand, strives towards economic prosperity through the deliberate promotion of corporate rescues, even when doing so may facilitate phoenixing.

The two countries have much in common, which makes these different approaches of particular interest. The UK would appear to be ahead of Australia by having similar names legislation expressly to tackle phoenix companies, although case law has shown the UK section both over- and under-reaches in this regard. Australia's own flirtation with these laws was properly abandoned, even with the qualifications incorporated into the draft legislation to avoid over-reaching. Australia's own tranche of anti-phoenixing laws, following the major Treasury proposals paper in 2009, were a disappointment. They focused primarily on revenue protection, with little of substance for other unsecured creditors.

Deterring fraudulent phoenix activity requires a focus not on overt actions – the creation, for example, of a new company carrying on the same business with a similar name – but rather on the intentions of its directors. It is tempting for regulators to look at overt actions because they are readily discernible. However, this is where the potential to interfere with legitimate business rescues is the greatest. If the laws are strict enough to capture the outward manifestations of phoenix activity, then they are likely to stifle any genuine attempt to preserve the company's business by those connected to the first company. This would be unfortunate. Equally, if the laws are less rigid, they are easily side-stepped by the deliberately deceitful and are likely to capture only the innocent entrepreneur concentrating on saving the business.

This is not to say that prosecuting directors for their improper actions in breach of their duties to their insolvent companies is easy. In a rescue culture such as the UK, and in the absence of a public regulator with power to bring directors' duties actions, the detection and prosecution

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& Customs (HMRC). *Review of HMRC Powers, Deterrents and Safeguards: Security for PAYE & National Insurance Contributions* <http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin925.htm> (accessed on 30 September 2013).

[202] Social Security Administration Act 1992, s121C. See HMRC, *INS44251 - What to investigate and how: Recovery of National Insurance Contributions from directors or other officers (Personal Liability Notices): What is a Personal Liability Notice?* The power has recently been used in *Leslie Livingstone v The Commissioners for Her Majesty's Revenue and Customs* [2010] UKFTT 56 (TC).

[203] See HM Revenue & Customs (HMRC). 'INS1121 - Insolvency and Insolvency Practitioners: Phoenix cases' <http://www.hmrc.gov.uk/manuals/insmanual/INS1121.htm> (accessed on 30 September 2013).

of these cases is particularly difficult. It is fair to ask whether the absence of actions against directors in relation to fraudulent phoenix activity is evidence of a lack of this behaviour or the turning of a blind eye, even if for the overall good of the economy as a whole.

Nonetheless, tolerating fraudulent phoenix activity in the name of the promotion of a dynamic rescue culture might be justified. Australia has no such excuse. Its reluctance to embrace more wide-ranging anti-phoenixing measures appears to stem from a generalised dislike of "red tape" and a fear that "innocent" directors might unwittingly face personal liability, rather than active support for a rescue culture. This approach seems to be a no-man's land, where fraudulent phoenix activity is decried but little is done to address it. ASIC has a vast remit,[204] and prosecuting phoenix activity is not high on its agenda.

That said, it is arguable that the privilege of incorporating a company is given away too easily in both countries. In the name of facilitating business, companies can be incorporated quickly and easily in Australia and the UK with relatively few questions asked. In Australia[205] only the name, address, and date and place of birth are sought, and these are not verified in any way. These are also requested in the UK, in addition to occupation and nationality.[206] One wonders whether an ounce of prevention might be worth a pound of cure in this context. If directors were required to be registered before starting a company, and that registration number were required for all dealings, this would enable easier pursuit of "corporate cowboys". Director registration could involve a lengthy questionnaire asking about associations with previously failed companies, and whether any of those companies had purchased assets from other failed companies.

This would of course increase the compliance burden which is so bitterly complained of worldwide. Nonetheless, such disclosure would provide useful intelligence for regulators and revenue authorities in tracking the activities of potential phoenix operators, and strong penalties could apply for misrepresentations or omissions. The amount of information required would correspond precisely with the extent of the would-be director's previous corporate history. Would it be such a bad thing for directors with "form" to be obliged to fill out a lengthy questionnaire? Are we so keen to have these "serial entrepreneurs" or "responsible risk-takers" starting yet another business that we fear putting them off with a bit of paperwork?

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[204] Its current priorities are listed on its website. They centre on 'confident and informed investors and financial consumers', 'fair and efficient financial markets', and 'efficient registration and licensing'. See ASIC, 'Our role' <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Our%20role> (accessed on 30 September 2013).

[205] See ASIC, Form 201 <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Starting%20a%20company%20or%20business#step6> (accessed on 30 September 2013).

[206] See Companies House, Form IN01 'Application to register a company' <http://www.companieshouse.gov.uk/infoAndGuide/companyRegistrationPaper.shtml> (accessed on 30 September 2013).