AUSTRALIAN GOVERNMENT, TREASURY

PROPOSED INDUSTRY FUNDING MODEL FOR THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION

Response to the November 2016 Proposals Paper

Submission by Professor Helen Anderson, Melbourne Law School

28th November 2016

I. INTRODUCTION

I thank the Treasury for this opportunity to respond to your Proposals Paper 'Proposed Industry Funding Model For The Australian Securities And Investments Commission'. This is my second submission on the proposed industry funding model, and it represents my own opinions on Treasury's proposal to fund ASIC.

As I noted previously, I lead a group of academics currently undertaking an Australian Research Council-funded project examining the regulation of illegal phoenix activity. Our aim is to devise ways in which this damaging behaviour can be most efficiently and effectively prevented and deterred, without damaging legitimate business activities to the detriment of the economy. We have now produced two major reports: *Defining and Profiling Phoenix Activity* and *Quantifying Phoenix Activity: Cost, Incidence, Enforcement.* Both are available from http://law.unimelb.edu.au/centres/cclsr/research/major-research-projects/regulating-fraudulent-phoenix-activity. Our third report outlining possible solutions will be released in February 2017.

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

I believe that liquidators play a vital role in detecting illegal phoenix activity, reporting it to ASIC and bringing recovery actions to assist creditor recovery. These functions rely on liquidators being properly funded. As I did in my previous submission, **I oppose any suggestion that a levy be placed on liquidators to contribute towards the funding of ASIC.** My own objections were not noted in the Proposal Paper's Chapter 6: Summary of Previous Consultation. Far more troubling is the fact that the objections of the Australian Restructuring, Insolvency and Turnaround Association (ARITA), the peak body representing external administrators, were not noted either.

II. LIQUIDATORS' ROLE IN RELATION TO ILLEGAL PHOENIX ACTIVITY

I refer Treasury back to my earlier submission but summarise its points as follows:

- ASIC refers to liquidators as 'gatekeepers' but this is not their statutory role.
- Liquidators have legal obligations to finalise the affairs of the company, distribute assets to creditors, and report to ASIC.
- Unlike all of the other regulated populations addressed in the proposals paper, liquidators of insolvent companies are **dealing with insolvent clients** where there may not be enough money to pay for their services.

Liquidators are financially squeezed by

- ASIC, which expects liquidators to be their investigators and enforcers;
- creditors, who want the insolvent company to pay as little as possible to liquidators so their own returns are maximised; and
- courts, who expect remuneration to be 'proportional'[1]: less may be charged for small insolvencies even if a thorough investigation would cost more.

Since the usual aim of illegal phoenix activity is to ensure that creditors such as the Australian Taxation Office and employees are not paid what they are entitled to, **liquidations of phoenixed companies commonly have few or no assets**. Illegal phoenixing succeeds because the very act of stripping assets from the liquidated company deprives the liquidator of the means to be paid for making a proper investigation. Section 545 of the *Corporations Act* makes it clear that there is no obligation to conduct any investigations beyond the bare minimum required for the statutory report.

In simple terms,

- the proposed industry funding levy operates as an additional cost on liquidators' practices;
- the less money liquidators have, the less investigation work they can perform for ASIC; and
- this is a *negative* outcome for ASIC, not a positive outcome.

III. THE PROPOSED LEVY

I have three concerns over the proposed levy:

- <u>ASIC does not need the money</u>

As noted previously, ASIC generates huge profits for the government. According to ASIC's latest annual report, 'ASIC raised $876 million for the Commonwealth in fees and charges, an increase of 6.4% from 2014-15'. Its total operating expenditure was $371 million. Why run the risk of interfering with liquidators' investigations of wrongdoing during insolvency for the sake of $8.5million, when ASIC turns a profit of over half a billion dollars?

- <u>Assetless Administration Fund now included</u>

The Proposals Paper makes it clear that the Assetless Administration Fund – a fund that liquidators apply to for funding of investigations where there are insufficient assets to cover their fees – will now be included in the model.[2] There were already significant problems for liquidators in obtaining this funding, which in any event is limited and depends upon a prior

---

[1] An excellent summary of the recent cases is available at http://www.cbp.com.au/publications/2015/december/remuneration,-expenses-and-proportionality-an-up

[2] Proposals Paper, 7 and 8.

(unfunded) investigation by the liquidator. Is it now suggested that liquidators be charged for applying for funding for assetless administrations?

- <u>Levy does not achieve its objective</u>

Liquidators are to be charged via an industry-wide levy (rather than a user-initiated service cost) and it appears the justification is to 'influence demand for government activities' and 'increase cost consciousness for all stakeholders by raising awareness of how much a government activity costs.'[3]

The paper does not explain how levying a $5,000 on all registered liquidators, with an additional $550 per appointment,[4] is likely to beneficially affect the behaviour of the few liquidators who engage in wrongdoing who need ASIC's regulatory supervision. Is there genuinely a belief that wrongdoers will mend their ways in the hope that the cost of their annual ASIC levy might decrease?

The paper then states that 'consideration will be given to moving to an "assets realised" levy based on information provided to ASIC in Annual Administration Returns lodged by registered liquidators'. While this may be an attempt to address assetless liquidations, unfortunately this mode of calculation of the levy is likely to encourage, rather than discourage, those few wrongdoers involved with illegal phoenix activity. Having misbehaved in some manner, possibly by facilitating the removal of assets as part of the phoenix activity, the liquidation will have few assets and thus a smaller levy will be payable.

---

[3] Proposals Paper, 5.

[4] Proposals Paper 37.