

AUSTRALIAN GOVERNMENT, TREASURY  
**PROPOSED INDUSTRY FUNDING MODEL FOR THE AUSTRALIAN  
SECURITIES AND INVESTMENTS COMMISSION**

Submission by Associate Professor Helen Anderson, Melbourne Law School  
15<sup>th</sup> September, 2015

---

## **I. INTRODUCTION**

I thank the Treasury for this opportunity to respond to your Consultation Paper ‘Proposed Industry Funding Model For The Australian Securities And Investments Commission’. 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. Our most recent output is a major report entitled Defining and Profiling Phoenix Activity, which is available from: <http://law.unimelb.edu.au/cclsr/centre-activities/research/major-research-projects/regulating-fraudulent-phoenix-activity>. This submission represents my own opinions on Treasury’s proposal to fund ASIC.

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. **I therefore oppose any suggestion that a levy be placed on liquidators to contribute towards the funding of ASIC.** I make no other comment on the issue of ASIC funding by industry.

## **II. LIQUIDATORS’ GATEKEEPER ROLE IN RELATION TO ILLEGAL PHOENIX ACTIVITY**

To begin, the enormous cost of phoenix activity to the economy must be recognised. In 2012, in a report into phoenix activity commissioned by the Fair Work Ombudsman, PriceWaterhouseCoopers estimated lost employee entitlements of between \$191,253,476 and \$655,202,019 annually.<sup>1</sup> That report also estimated losses generally to business to be between \$1,784,338,743 and \$3,191,142,300 annually.<sup>2</sup> This highlights the importance of ensuring that this economically damaging behaviour is detected and prosecuted through all available avenues.

---

<sup>1</sup> PriceWaterhouseCoopers, ‘Phoenix Activity: Sizing the Problem and Matching Solutions’ (Report Prepared for the Fair Work Ombudsman, June 2012), iii.

<sup>2</sup> Ibid.

The Consultation Paper acknowledges ASIC's view that '[r]egistered liquidators are gatekeepers in the financial system.'<sup>3</sup> However, this is not the role assigned to them by the *Corporations Act 2001* (Cth). Rather, in simple terms, the Act recognises that liquidators are responsible for finalising the affairs of companies being wound up, recovering company assets including via litigation, and distributing them amongst eligible creditors.<sup>4</sup>

Nonetheless, liquidators accept the gatekeeper role that has apparently developed from their statutory duty to report at the conclusion of an engagement. Section 545 of the Act provides that:

**(1) Subject to this section, a liquidator is not liable to incur any expense in relation to the winding up of a company unless there is sufficient available property.**

(2) The Court or ASIC may, on the application of a creditor or a contributory, direct a liquidator to incur a particular expense on condition that the creditor or contributory indemnifies the liquidator in respect of the recovery of the amount expended and, if the Court or ASIC so directs, gives such security to secure the amount of the indemnity as the Court or ASIC thinks reasonable.

**(3) Nothing in this section is taken to relieve a liquidator of any obligation to lodge a document (including a report) with ASIC under any provision of this Act by reason only that he or she would be required to incur expense in order to perform that obligation.**

This reporting is done in compliance with Regulatory Guide 16: External administrators - Reporting and Lodging, available at <http://asic.gov.au/for-finance-professionals/registered-liquidators/applying-for-and-managing-your-liquidator-registration/rg-16-external-administrators-reporting-and-lodging/> A central part of this reporting relates to misconduct before and during external administrations by corporate controllers. Liquidators notify ASIC whether they suspect the conduct breaches civil penalty or criminal laws, and whether they hold documentary evidence to support their claims. This is vital intelligence that ASIC uses to select cases to pursue further.

Two important aspects of s 545 with particular significance to illegal phoenix activity warrant highlighting:

- that liquidators have a statutory obligation to report, whether they are paid for it or not, but
- beyond that obligation, they are not required to do any work for which they will not be paid.

Since the usual aim of illegal phoenix activity is to ensure that creditors 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 makes it clear that there is no obligation to conduct any investigations beyond the bare minimum required for the statutory report.

To my knowledge, registered liquidators are the only profession which has a statutory obligation to perform unpaid work. It must be remembered that they are private sector

---

<sup>3</sup> Consultation Paper, page 49.

<sup>4</sup> *Corporations Act 2001* s 477

professionals, with the usual expenses of wages, rent, tax and so forth. They must ensure that they perform their reporting role in accordance with statutory requirements and professional (ARITA) guidelines.

It is no exaggeration to say that no-one is as close to the affairs of a failed company as a liquidator and therefore no-one else can determine whether it is a legal or illegal phoenix with the same degree of experience and knowledge of the law. In order for liquidators to do a proper job, they frequently rely on cross-subsidisation from their other liquidations where their fees are paid. This underscores the absolute importance of ensuring that liquidators have the means to operate profitably.

### **III. LIQUIDATORS AS OBJECTS OF REGULATION**

It seems that in defining liquidators' role as gatekeepers on behalf of ASIC, the emphasis has shifted from liquidators as allies to liquidators as potential offenders. This is reflected in the Consultation Paper's comment that:

'Registered liquidators are gatekeepers in the financial system and regulation works to ensure that liquidators fulfil their role diligently and transparently. Consequently, ASIC focuses on: competence; independence; and ensuring that liquidators do not improperly gain from their appointments.'<sup>5</sup>

In my opinion, this shift has occurred because of a growing tension over resourcing. ASIC itself lacks the resources to play a significant detection role in relation to illegal phoenix activity, instead relying on their liquidator-gatekeepers for information. As noted above, liquidators are financially under pressure to produce reports in relation to unfunded phoenix liquidations. It is appropriate that ASIC devote some of its scarce resources to the supervision of liquidators but if liquidators are to be ASIC's gatekeepers, they should be given every opportunity to be financially able to do so. They should not be subject to a new impost that further strains their capacity to make thorough investigations of assetless administrations on ASIC's behalf.<sup>6</sup> This is acknowledged by the Consultation Paper when it says:

In contrast, the levies would likely be proportionately high for liquidators that complete a large number of low value liquidations. In an extreme case, this could potentially result in a levy that exceeds their income from very low value liquidations.<sup>7</sup>

While ASIC administers the Assetless Administration Fund to provide funding for liquidators, the amounts available are limited and depend upon a prior (unfunded) investigation by the liquidator seeking funding. The funding is not available to liquidators seeking asset recoveries for the benefit of creditors.<sup>8</sup>

### **IV TWO FINAL OBSERVATIONS**

As I noted in my introduction, I am not taking the opportunity to comment on proposed levies on other ASIC-regulated entities. However, it should be acknowledged that the Government already derives large amounts as a result of ASIC's corporate registry function. ASIC's 2013-

---

<sup>5</sup> Consultation Paper p 49.

<sup>6</sup> Because these administrations involve companies with no or few assets, there is nothing for the liquidator to recover for its creditors.

<sup>7</sup> Consultation Paper p 51.

<sup>8</sup> See Australian Securities and Investments Commission, *Regulatory Guide 109: Assetless Administration Fund: Funding Criteria and Guidelines*, November, 2012.

2014 Annual Report notes<sup>9</sup> that ASIC derived in that year \$763 million in fees and charges, with operating expenses of \$405 million. This is a \$358 million profit and is arguably the driver behind the Government's plan to privatise ASIC's registry, announced in the May 2015 Federal Budget.

I also take issue with the Consultation Paper's comment by the Assistant Treasurer that the Government considers that an industry funding model for ASIC would ensure that the costs of the regulatory activities undertaken by ASIC are borne by those creating the need for regulation (rather than all taxpayers) ...

With respect, I believe this comment to be short-sighted in relation to the role played by liquidators, especially in relation illegal phoenix activity. Clearly liquidators do not create the need for regulation of illegal phoenix activity. In fact, by acting as ASIC's gatekeepers and reporting corporate misconduct, they are working to reduce the impact of this illegal behaviour for the benefit of all taxpayers. While the supervision of liquidators is vital and is a cost that ASIC is required to bear, I believe, for the reasons articulated above, that imposing that cost on liquidators themselves is counterproductive.

---

<sup>9</sup> ASIC Annual Report 2013-2014, p 24.