

Illegal Phoenix activity:

What do AICM members think about it?

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Illegal phoenix activity is a blight on Australia's corporate sector that has been occurring for decades. It often involves directors of a company deliberately putting the company into external administration after shifting its assets to a new company (a "phoenix" company that "rises from the ashes") to defraud creditors, employees and taxation authorities. While the exact scale of the problem is unknown, the most recent estimates suggest that phoenix activity is costing the Australian economy billions of dollars per year.

In 2009 the ATO estimated that phoenix activity and related practices cost between \$1 billion and \$2.4 billion each year. In 2012 PricewaterhouseCoopers estimated the total cost to employees, business and

government revenue at between \$1.78 billion and \$3.19 billion annually.

In early 2016 researchers at The University of Melbourne and Monash University conducted a survey of about 2,300 AICM members to find out what they think about illegal phoenix activity and to learn about their encounters with phoenix operators. The 155 survey respondents – a response rate of approximately 7% – expressed concerns about high rates of phoenix activity and damaging consequences for creditors, dodgy industry practices that increase the risk of illegal phoenix activity, and the failure of regulatory authorities to adequately address the phoenix problem.

One third of the survey respondents believed that phoenix activity has "often"



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or “always” occurred where directors are applying for credit and they have a history of involvement in failed companies, while another third of respondents believed that phoenix activity has “sometimes” occurred. Less than one third of respondents believed that phoenix activity has “rarely” or “never” occurred. Overall, the respondents’ views suggest that, where a company director applies for credit and has a history of being involved in failed companies, there is a significant likelihood that they have engaged in phoenix activity. This is a very concerning result given that phoenix activity often involves serious civil and/or criminal illegality and collectively costs creditors, employees and taxation authorities billions of dollars per year.

One factor that could contribute to this high rate of phoenix activity is a lack of appropriate business skills and ethical trading practices. Over half of the survey respondents said that directors who have been involved in failed companies “often” or “always” have inadequate business skills, while a further one third of respondents said that they “sometimes” have inadequate skills. One respondent observed that “there is no prerequisite to incorporating a company and commencing business. No formal qualifications are necessary, hence many directors are doomed to fail purely due to a lack of knowledge and business acumen.” Perhaps even more concerning is that 90% of respondents “agreed” or “strongly” agreed that directors or manager of failed companies tend to display little

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regard for the company’s creditors. As one respondent remarked, “directors of phoenix companies have little regard for trading ethically. In general they are arrogant and believe they are above the law.”

So why do they believe they are above the law, and what is the law doing about it? Not enough, according to the survey respondents. Part of the problem is a lack of funding, with over 60% of respondents “disagreeing” or “strongly disagreeing” that ASIC has sufficient resources. But there were also serious concerns about the lack of information made available by ASIC and the ATO to allow creditors to protect their commercial interests. An overwhelming 95% of respondents “agreed” or “strongly agreed” that ASIC should allow credit ratings agencies access to information supplied by liquidators to enhance the quality of advice they can provide to their customers. The same proportion of respondents “agreed” or “strongly agreed” that it would significantly enhance credit approval decision-making if the ATO were to list unpaid tax by commercial entities. If credit managers were equipped with this sort of information, they would

be in a much stronger position to protect creditors from illegal phoenix operations. As one respondent commented, the listing of unpaid tax by the ATO would be “extremely useful” because “tax debt is present in all insolvencies and would be a highly effective warning sign when it starts to accrue.”

In addition to better funding for regulatory agencies and access to information on corporate dealings and liabilities, the survey respondents strongly supported measures to tighten regulation of company directors and bolster enforcement when they go rogue. About 97% of respondents “agreed” or “strongly agreed” that all company directors should be issued with a Director Identification Number to enable ASIC and the ATO to track directors of multiple failed companies. A similar proportion “agreed” or “strongly agreed” that directors of multiple failed companies should be prohibited from managing another company unless they prove they are competent to do so. Several respondents also stressed the need for strong enforcement and penalties, with one respondent commenting that “directors of past failed companies should be banned for up to 5 years from managing another business” and that “failure to comply should result in severe financial penalties and potential jail terms.”

These survey results show that there is much that can be done, and much that needs to be done as a matter of priority, to better protect creditors, employees and taxation authorities from the devastating effects of illegal phoenix activity. ◇

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