PHOENIX ACTIVITY

RECOMMENDATIONS ON DETECTION, DISRUPTION AND ENFORCEMENT

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ABBREVIATIONS

AAF	Assetless Administration Fund
AAT	Administrative Appeals Tribunal
ABN	Australian Business Number
ABR	Australian Business Register
ACCC	Australian Competition and Consumer Commission
ACN	Australian Company Number
AFSA	Australian Financial Security Authority
AIC	Australian Institute of Criminology
AICM	Australian Institute of Credit Management
ALRC	Australian Law Reform Commission
ARITA	Australian Restructuring Insolvency and Turnaround Association
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
BAS	Business Activity Statement
CDPP	Commonwealth Director of Public Prosecutions
DE	Department of Employment
DIN	Director Identification Number (see [1.1.1])
DPN	Director Penalty Notice
EXAD	External Administration
FEG	Fair Entitlements Guarantee
FWO	Fair Work Ombudsman
GAAR	General Anti-avoidance Rule
GST	Goods and Services Tax
IAPF	Inter-agency Phoenix Forum
IGT	Inspector-General of Taxation
MOU	Memorandum of Understanding
PAYG(W)	Pay As You Go (Withholding)
PwC	PricewaterhouseCoopers
QBCC	Queensland Building and Construction Commission
RATA	Report as to Affairs
SERC	Senate Economics References Committee
SGC	Superannuation Guarantee Charge
SIP 16	Statement of Insolvency Practice 16
SME	Small and Medium-sized Enterprises
STP	Single Touch Payroll
TFN	Tax File Number
VA	Voluntary Administration

EXECUTIVE SUMMARY

This is the third and final report of the project, Phoenix Activity: Regulating Fraudulent Use of the Corporate Form ('Phoenix Project'), which is being undertaken by staff at Melbourne Law School and Monash Business School. The Phoenix Project is funded by the Australian Research Council's *Discovery Projects* funding scheme (Project DP140102277). The Project seeks to enhance Australia's economic stability by determining the best methods of addressing fraudulent use of the corporate form without unduly inhibiting its proper use.

Phoenix activity essentially involves one company taking over the business of another company that is wound up or abandoned where the controllers of both companies are the same people or their associates – Newco arising from the ashes of Oldco, having shed Oldco's debts and other obligations. In practice, phoenix activity has many guises. Newco may be newly formed or may already be in existence; Oldco may or may not transfer assets to Newco, and if it does transfer assets, the price may or may not be arm's length. Oldco's controllers may have legitimate or improper motives.

In our first report, Defining and Profiling Phoenix Activity,[1] we identified five categories of phoenix activity.[2] The first is 'legal phoenix', often referred to as 'business rescue', which results in a better outcome for creditors and society than letting the business come to an end.[3] The second is 'problematic phoenix', which is technically legal but involves repeated resurrection of the business by inept entrepreneurs that is harmful to creditors and society.[4] There are three categories of illegal phoenix activity, depending upon whether it involves an unpremeditated intention to defraud creditors arising from financial difficulties ('illegal type 1'),[5] an intention to defraud as part of a premeditated business model ('illegal type 2'),[6] or a premeditated intention to defraud accompanied by other illegal activity ('complex illegal').[7] In this report we use the umbrella term 'harmful phoenix activity' to refer to both 'problematic' phoenix activity and the three categories of 'illegal' phoenix activity.

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1 Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, 'Defining and Profiling Phoenix Activity' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, December 2014) ('*Defining and Profiling Phoenix Activity Report*').
2 See ibid 2.
3 See ibid 8–10.
4 See ibid 11–12.
5 See ibid 15–16.
6 See ibid 24.
7 See ibid 27–28.

Estimates have placed the economic cost of phoenix activity in the billions of dollars.[8] In our second report, Quantifying Phoenix Activity: Incidence, Cost, Enforcement,[9] we published the results of our empirical study on the incidence and cost of phoenix activity, along with disruption and enforcement measures taken in relation to such activity. While precise quantification was not possible due to a lack of data, our conclusion was that harmful phoenix activity is a significant problem that justifies the commitment of substantial government resources.[10] Several organisations have raised concerns about the widespread and costly nature of phoenix activity.

- Australian Securities and Investments Commission:
  - '11,494 companies [were] identified for the potential to conduct illegal phoenix activity.'[11]
  - 'As part of our proactive phoenix surveillance program, we have identified approximately 2,500 directors who meet the criteria for triggering the director disqualification provisions of the Corporations Act. These directors currently operate over 7,000 registered companies.'[12]
  - 'Illegal phoenix activity has far-reaching and unfair consequences. Employees lose wages and entitlements, and creditors—many of whom are small businesses—are left with debts. There are significant unpaid tax liabilities, which have a detrimental impact on tax revenue.'[13]

- Senate Economics References Committee, *Inquiry into Insolvency in the Australian Construction Industry*, 2015:
  - '[I]llegal phoenix activity remains a significant issue not only in the construction industry, but throughout the economy.'[14]
  - '[T]he estimates of the cost of illegal phoenix activity … suggest a significant culture of disregard for the law. This view is reinforced by the anecdotal evidence received by the committee which indicates that phoenixing is

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8 See PricewaterhouseCoopers and Fair Work Ombudsman ('FWO'), *Phoenix Activity: Sizing the Problem and Matching Solutions* (June 2012); Australian Taxation Office ('ATO'), *Targeting Tax Crime: A Whole-of-Government Approach* (July 2009) 16; Treasury (Cth), *Action against Fraudulent Phoenix Activity: Proposals Paper* (November 2009) ('*Phoenix Proposals Paper*').

9 Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, 'Quantifying Phoenix Activity: Incidence, Cost, Enforcement' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, October 2015) ('*Quantifying Phoenix Activity Report*').

10 See ibid xix.

11 Australian Securities and Investments Commission ('ASIC'), *Annual Report 2015-2016* (14 October 2016) 22.

12 ASIC, *Report 444: ASIC Enforcement Outcomes – January to June 2015* (August 2015) [40].

13 ASIC, *Report 421: ASIC Enforcement Outcomes – July to December 2014* (January 2015) [28].

14 Senate Economics References Committee ('SERC'), Parliament of Australia, *'I just want to be paid': Insolvency in the Australian Construction Industry* (2015) xix ('*SERC Construction Insolvency Report*').

considered by some in the industry as merely the way business is done in order to make a profit.'[15]

- Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, 2015:
  - '[E]ven conservative estimates suggest that [illegal phoenix activity] is a significant issue. In terms of the number of phoenix companies, estimates range from between 2000 and 3000 engaging in phoenix activity through liquidation every year, with the lower bound likely to be the more reliable estimate, to an ATO estimate of a total of 6000 phoenix companies operating in Australia in 2011.'[16]
  - '[Illegal phoenix activity] has considerable scope to undermine the confidence of creditors in the insolvency framework, and therefore hinder the efficient closure of business.'[17]

- PricewaterhouseCoopers, *Phoenix Activity: Sizing the Problem and Matching Solutions*, commissioned by the Fair Work Ombudsman, 2012:
  - 'On the basis of the available data and a series of assumptions that were tested with stakeholders, the total impact of phoenix activity has been estimated to be $1.78 – $3.19 billion per annum.'[18]

- Bruce Collins QC, *Independent Inquiry into Construction Industry Insolvency in NSW*, commissioned by the NSW Government, 2012:
  - 'A number of stakeholders raised the issue of phoenixing with the Inquiry and their view that this activity was widespread in the building industry and that it was having a significant and lasting detrimental effect on their businesses.'[19]
  - 'The flight of the phoenix is prevalent in the building and construction industry in NSW.'[20]

- Australian Taxation Office, *Targeting Tax Crime: A Whole-of-Government Approach*, July 2009:
  - 'The cost to the Australian economy of phoenix and related practices has been estimated at between $1 billion and $2.4 billion a year.

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15 Ibid [5.33].

16 Productivity Commission, *Business Set-up, Transfer and Closure*, Report No 75 (2015) 423 ('*Business Set-up Report*'). Footnotes omitted.

17 Ibid 28.

18 PricewaterhouseCoopers and FWO, above n 8, ii–iii.

19 Bruce Collins QC, *Independent Inquiry into Construction Industry Insolvency in NSW* (November 2012) 33.

20 Ibid 34.

This cost includes competitors being unfairly priced out of business, trade creditors being left unpaid and employees missing out on vital superannuation payments.

The Australian community also bears a significant part of this cost through reduced tax revenue.'[21]

- Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, 2004:
  - '[M]any submissions commented on the nature and incidence of illicit phoenix company activity. Almost all regarded the problem as a serious one requiring the attention of the legislature and were supportive of strengthening measures against phoenix companies.'[22]

- Royal Commission into the Building and Construction Industry, 2003:
  - 'There has been significant incidence of fraudulent phoenix company activity in the building and construction industry. Since 1998 the Australian Taxation Office has raised at least $110 million in taxes and penalties from the detection of fraudulent phoenix company activity in the building and construction industry. For every $1 spent by the Australian Taxation Office on the detection of phoenix company activity in the period 1 July 2001 to 30 June 2002 $8 in revenue was raised. Efforts must continue to eliminate fraudulent phoenix company activity in the building and construction industry. Apart from the contraventions of law involved, fraudulent phoenix company activity can adversely affect the public revenue, contractors, employees and creditors.'[23]

- Victorian Law Reform Committee, *Curbing the Phoenix Company: Second Report*, 1995:
  - 'The problem of the phoenix company is common and perhaps endemic. It should not be ignored. Attempts to find remedies and to strike the right balance between competing considerations cannot be expected to result in a once and for all solution and should be kept under review.'[24]

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21 ATO, above n 8, 16.

22 Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004) [8.35].

23 Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report: Reform – National Issues Part 2* (February 2003) 164 ('*Cole Royal Commission Report*').

24 Victorian Law Reform Committee, *Curbing the Phoenix Company: Second Report on the Law Relating to Directors and Managers of Insolvent Corporations*, Report No 43 (1995) [4.9].

Our surveys of members of the Australian Restructuring Insolvency and Turnaround Association ('ARITA')[25] and the Australian Institute of Credit Management ('AICM')[26] bear out the above comments regarding the prevalence of harmful phoenix activity. Thirty percent of ARITA respondents said they 'often' encounter liquidations where they believe phoenix activity has occurred, and 51% said they 'sometimes' do. A significant proportion of the phoenix activity encountered by the respondents involved suspected unlawful conduct. Twenty-four percent of respondents said they 'always' allege a breach of civil obligations in an EXAD report where they believe phoenix activity has occurred, and 29% said they 'often' do. The AICM survey yielded similar results. Twenty-eight percent of AICM respondents said they 'often' believe, and 33% said they 'sometimes' believe, that phoenix activity has occurred in cases where directors are applying for credit and the respondents know the directors have been involved in other failed companies in the past. In regard to the consequences of phoenix activity, 27% of ARITA respondents said the liquidation of a company involving phoenix activity 'always' results in zero returns to creditors, and 60% said it 'often' does.[27]

Harmful phoenix activity, left unchecked, has the capacity to undermine Australia's revenue base and the competitive 'level playing field'. It is wrong that legitimate business operators, paying taxes, wages and other debts, might be driven out of business by those engaging in harmful phoenix activity. Minimising business distrust caused by harmful phoenix activity can lower the cost of finance and make it more widely available. If less tax revenue is fraudulently avoided, the economy and society as a whole benefit. If fewer employee entitlements are lost as a result of harmful phoenix activity, there is likely to be less reliance on the Fair Entitlements Guarantee, freeing up government resources for other purposes.

The aim of this report is to minimise the significant damage that is being done to the Australian economy by harmful phoenix activity without unduly inhibiting legitimate

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25 ARITA is a professional association with over 2,000 members that represents those who specialise in the fields of restructuring, insolvency and turnaround, including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring: ARITA, *About Us* <http://www.arita.com.au/about-us>. The survey of ARITA members was conducted on Survey Monkey from 16 November 2015 to 14 December 2015. The survey was sent to 2,155 members, 213 of whom completed the survey – a response rate of approximately 10%. The questions were optional and the percentage of members who responded to each question ranged from 29% to 100%.

26 AICM is Australia's leading professional member body for commercial and consumer credit management professionals, with over 2,300 members responsible for maximising the cash flow and minimising the bad debt risk of more than 1,300 Australian companies, including 34 of the ASX100: AICM, *About AICM* <http://aicm.com.au/about-aicm/>. The survey of AICM members was conducted on Survey Monkey from 11 January 2016 to 15 February 2016. The survey was sent to just over 2,300 members, 155 of whom completed the survey – a response rate of approximately 7%. The questions were optional and the percentage of members who responded to each question ranged from 37% to 100%.

27 For further discussion of these surveys, see Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, 'At the Coalface of Corporate Insolvency and Phoenix Activity: A Survey of ARITA and AICM Members' (2016) 24 *Insolvency Law Journal* 209.

business rescues and beneficial entrepreneurialism. Our recommendations address phoenix activity that, whether presently legal or not, society should not tolerate because it causes unacceptable harm to others.

Our first report identified the multitude of legislative provisions that regulators can use to take action against harmful phoenix activity.[28] These provisions are, for the most part, oriented towards *ex-post* enforcement action. While strong and targeted enforcement is the vital bedrock upon which any regime to eradicate wrongdoing is built, it is only part of the solution, particularly given that not all harmful phoenix activity is illegal (i.e. problematic phoenix activity). Our approach is to attack the drivers of harmful phoenix activity from multiple angles, with a greater focus on *ex-ante* detection and disruption. At present, phoenix activity is easy, cheap, profitable and largely invisible, as a result of which there is little enforcement even where actions are available. We believe that implementing the measures outlined in this report would significantly counteract each of those drivers and reduce rates of harmful phoenix activity. At the same time, nothing we suggest will prevent genuine entrepreneurs from starting new companies, even after previous corporate failures.

Our recommendations come in three chapters.

CHAPTER 1: DETECT ALL PHOENIX ACTIVITY

- Identify directors properly.
- Tighten the processes for incorporating companies.
- Assist external administrators to collect information.
- Overhaul external administrator reporting to ASIC.
- Revise website information and complaint processes for the public.
- Share information more effectively between regulators, including in relation to abandoned and deregistered companies.
- Make information about directors' corporate histories available free-of-charge where possible.
- Establish an online, free-of-charge, publicly searchable register of disqualified directors and associated companies.
- Enhance information sharing with 'allies' such as super funds, trade unions and credit reporting agencies.
- Improve collection of statistical data about phoenix activity.

[28] See Anderson et al, *Defining and Profiling Phoenix Activity Report*, above n 1, 10–13, 16–17, 24–25, 28.

CHAPTER 2: DISRUPT HARMFUL PHOENIX ACTIVITY

- Introduce for those with a history of corporate failures a new 'halfway' category of 'restricted directorships', listing these on a publicly searchable register along with disqualified directors.
- Impose consequences for being a restricted director, including:
  - Place limits on the number of concurrent directorships.
  - Increase reporting requirements and regulatory scrutiny.
  - Consider voluntary education for restricted directors.
- Improve the regime for disqualification from managing companies:
  - Prioritise the use of disqualification powers in the phoenix context.
  - Increase the maximum period of ASIC disqualification orders.
  - Allow the FWO and ATO to seek court ordered disqualification.
  - Increase the penalties for managing a company whilst disqualified.
- Check ABN applicants against the ASIC registers of disqualified and restricted directors.
- Introduce independent valuations of asset transfers between related parties.
- Substantially limit backdating of directorships.
- Include GST in the ATO administered Director Penalty Notice ('DPN') regime and introduce DPNs into state taxation legislation.
- Expand Single Touch Payroll to include payment of tax and superannuation.

CHAPTER 3: PUNISH AND DETER HARMFUL PHOENIX ACTIVITY

- Clarify the role of liquidators in the enforcement process and provide them with adequate funding.
- Prioritise taking enforcement action in the phoenix context.
- Improve reporting of enforcement actions against harmful phoenix activity to stimulate general deterrence.
- Amend existing laws that do not work effectively.
- Increase the penalties for breaches of directors' duties and individuals who deliberately liquidate companies to avoid *Fair Work Act* penalties.
- Remove the benefit gained from harmful phoenix activity.
- Expressly address the role of advisors, particularly pre-insolvency advisors.

The two final chapters of the report discuss other ideas and proposals related to phoenix activity in respect of which we have not formulated specific recommendations. In Chapter 4 we discuss other ideas from Australia and abroad that may warrant further consideration:

- Enabling recovery of Oldco's debts from other companies that are related to Oldco by way of franchise or labour hire arrangements.

- Introducing specific rules for certain industries that have a high incidence of harmful phoenix activity.
- Enabling recovery of assets where their transfer has the effect of perpetrating a fraud on employees.
- Making directors liable for company debts where they are disqualified and the conduct for which they are disqualified has caused loss to creditors.

In Chapter 5 we discuss a number of proposals that we think would *not* work to combat harmful phoenix activity or that may increase the risk of harmful phoenix activity:

- A phoenix offence.
- Mandatory capitalisation.
- Compulsory education for all directors.
- Reinstating the tax priority in liquidation.
- More tax offences or more tax civil penalty provisions.
- We also express our concerns about the effect that pre-pack liquidations, streamlined liquidations or a safe harbour defence might have on harmful phoenix activity.

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We welcome comments on our recommendations.

PREVIOUS PUBLICATIONS RELATED TO PHOENIX ACTIVITY

Reports

Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, 'Quantifying Phoenix Activity: Incidence, Cost, Enforcement' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, October 2015).

Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, 'Defining and Profiling Phoenix Activity' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, December 2014).

Book chapters

Helen Anderson, 'Corporate Law and the Phoenix Company' in Roman Tomasic (ed) *Routledge Handbook of Corporate Law* (Routledge, 2017) 114.

Helen Anderson, 'Side-stepping Labour Law through the Corporate Form' in John Howe, Anna Chapman and Ingrid Landau (eds) *The Evolving Project of Labour Law: Foundations, Development and Future Research Directions* (Federation Press, forthcoming in 2017).

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Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, 'Illegal Phoenix Activity: Is a "Phoenix Prohibition" the Solution?' (2017) *Company and Securities Law Journal* (forthcoming).

Helen Anderson, 'Understanding the Phoenix Landscape for Employees' (2016) 29 *Australian Journal of Labour Law* 257.

Helen Anderson, 'Sunlight as The Disinfectant for Phoenix Activity' (2016) 34 *Company and Securities Law Journal* 257.

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Michelle Welsh and Helen Anderson, 'The Public Enforcement of Sanctions against Illegal Phoenix Activity: Scope, Rationale and Reform' (2016) 44 *Federal Law Review* 201.

Helen Anderson, Ian Ramsay and Michelle Welsh, 'ASIC, Phoenix Activity and the View from the Outside' (2016) 34 *Company and Securities Law Journal* 625.

Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, 'At the Coalface of Corporate Insolvency and Phoenix Activity: A Survey of ARITA and AICM Members' (2016) 24 *Insolvency Law Journal* 209.

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Helen Anderson and Linda Haller, 'Phoenix Activity and the Liability of the Advisor' (2014) 36 *Sydney Law Review* 471.

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Helen Anderson, 'The Proposed Deterrence of Phoenix Activity: An Opportunity Lost?' (2012) 34 *Sydney Law Review* 411.

Helen Anderson, 'Comment on Consultation Paper 180: ASIC's Power to Wind Up Abandoned Companies' (2012) 30 *Company and Securities Law Journal* 528.

Helen Anderson, 'Phoenix Activity and the Recovery of Unpaid Employee Entitlements – Ten Years On' (2011) 24 *Australian Journal of Labour Law* 141.

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Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, 'Illegal Phoenix Activity from the Insolvency Practitioner's Perspective' (2016) 28(4) *ARITA Journal* 23.

Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, 'Illegal Phoenix Activity: What Do AICM Members Think about It?' (2016) 24(1) *Credit Management in Australia* 18.

Helen Anderson, 'FEG, Moral Hazard and the Innovation Agenda' (2016) 28(2) *ARITA Journal* 28.

H Anderson, 'Quantifying Illegal Phoenix Activity' (2015) 27(4) *Australian Insolvency Journal* 30.

Helen Anderson, 'Phoenix Activity – A Context not a Crime' (2015) 27(2) *Australian Insolvency Journal* 35.

Helen Anderson, 'An Ounce of Prevention: Practical Ways to Hinder Phoenix Activity' (2013) 25(3) *Australian Insolvency Journal* 16.

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Helen Anderson, Submission to Treasury (Cth), *Proposed Industry Funding Model for the Australian Securities and Investments Commission: Proposals Paper*, 28 November 2016.

Helen Anderson, Ian Ramsay and Michelle Welsh, Submission to Productivity Commission, *Inquiry into Data Availability and Use*, 5 May 2016.

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Helen Anderson, Submission to Treasury (Cth), *Proposed Industry Funding Model for the Australian Securities and Investments Commission: Consultation Paper*, 15 September 2015.

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Helen Anderson, Ian Ramsay, Ann O'Connell and Michelle Welsh, Submission No 1 to Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, 11 February 2015.

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Helen Anderson, Submission to Treasury (Cth), *Corporations Amendment (Phoenixing and Other Measures Bill) 2012 – Exposure Draft; Corporations Amendment (Similar Names) Bill 2012 – Exposure Draft*, 19 January 2012.

CHAPTER 1: DETECT ALL PHOENIX ACTIVITY

Recommendation 1: Require directors to obtain a Director Identification Number

- Directors of companies should be required to obtain a director identification number ('DIN') after proving their identity with 100 points of identification.
- At the time of annual reviews or annual returns for existing companies, directors should be required to quote their DIN.
- In relation to previously deregistered companies, directors should be required to provide information about these companies as part of the process of obtaining a DIN.
- A penalty should apply for omitted or incorrect information.
- The DIN should be password protected for directors' interactions with regulators.
- Like a company's ACN and ABN, the DIN should be visible to the public, and, in particular, prospective employees and creditors, via the company's documentation or website, to enable searches of the director's prior corporate history.
- Directors should be subject to a duty to keep company documentation and websites current regarding their DIN.
- A small charge should be levied on prospective directors applying for a DIN to help defray the cost of implementing the system.

Recommendation 2: Make the process for incorporating companies more transparent

- The process of incorporation should be online with the prospective directors quoting their DINs.
- The DIN should be quoted for changes of directorship within existing companies.
- While the DIN should enable the application form for registration as an Australian company to pre-populate with previous incorporation history, directors should be required to supply missing information.
- The government should review the desirability of business service providers selling aged shelf companies.

Recommendation 3: Provide additional information in reports as to affairs (RATA)

- ASIC should supply pre-populated RATA documents to liquidators containing information held by ASIC.
- There should be no cost to liquidators for the information contained in the pre-populated document.
- The RATA form should be amended to require additional information about:

- the directors;
- previous company failures with which the directors have been associated; and
- significant asset transfers by the insolvent company within the past 12 months.

Recommendation 4: Increase the penalties for failing to inform and assist liquidators

- The penalty for a failure to provide books and records should be substantially increased.
- The penalty for failure to provide a RATA or failure to provide accurate and adequate information in a RATA should be substantially increased.

Recommendation 5: Collect additional information via external administrators' reports

- EXAD Reports should be amended to include:
  - a question about whether phoenix activity was suspected;
  - a question about the involvement of pre-insolvency advisors;
  - some space in which liquidators can advise ASIC of the specific details of phoenix activity and any other relevant information about the company and its directors; and
  - a method by which external administrators could indicate to ASIC which reports required 'the most urgent attention and investigation'.

Recommendation 6: Improve the advice and complaint functions on regulator websites

- To improve the detection of phoenix activity, there should be a clear and consistent message across regulator websites about what phoenix activity is, how to report suspected phoenix activity, what avenues of redress are available to victims, and how to obtain further advice.
- As a task of the Interagency Phoenix Forum, regulators should endeavour to devise a common format for their phoenix information and complaint webpages.
- The FWO should add phoenix activity as an issue that can be reported on its Anonymous Report webpage.
- Complaint mechanisms should be straightforward, such as the ATO's direct phoenix email address.
- ASIC should revise its phoenix information and complaint webpages to ensure that they are accurate and user-friendly.

Recommendation 7: Increase information sharing between regulators

- The recommendation of the 2015 SERC Construction Insolvency Report that 'consideration be given to amending confidentiality requirements in statutory frameworks of agencies participating in the Phoenix Taskforce to permit

dissemination of relevant information to the ATO' should be implemented, and these amendments should be extended so that information can be given to other agencies via the Australian Business Register.

- The disclosure laws under the *Fair Work Act* should be considered as a possible template for information disclosure generally.
- The ABR should be directed to alert ASIC and other agencies, via the ABR Explorer, if it discovers that the people associated with a cancelled ABN are seeking a new ABN.
- Prior to deregistering a company, ASIC should notify other members of the Phoenix Taskforce of the name and ACN of the company *and* the names and DINs of its directors. Upon notification, the other members of the Phoenix Taskforce should search their databases to check whether the company or its directors have outstanding liabilities and, if so, refer the matter for enforcement action.

Recommendation 8: Make information about companies public and free-of-charge

- Australia should follow the lead set in the United Kingdom and some European countries by allowing free searches of lodged company and director information.
- ASIC should review and clarify its ability to disclose information about companies and their directors and update its regulatory guidance accordingly.
- Where necessary, exemptions should be made to the *Privacy Act* to allow easy searching and location of directors' corporate histories.

Recommendation 9: Establish an online register of restricted & disqualified directors

- ASIC should establish registers of directors who are restricted (see Recommendation 14) or disqualified that:
    - are online and available via the ASIC website with a user-friendly interface;
    - are entirely free-of-charge to view and download linked documents;
    - can be both browsed and searched using key terms via a search engine function;
    - contain hyperlinks to the disqualification orders *and* the reasons for the orders (in the case of non-automatic disqualification);
    - provide the name and ACN of all companies of which the disqualified or restricted person is or has been an officer; and
    - subject to feasibility considerations, include people who are automatically disqualified from managing corporations under s 206B of the *Corporations Act*.

Recommendation 10: Increase information sharing between super funds and regulators

- There should be better liaison between the ATO, ASIC and superannuation funds to assist early detection.
- Privacy provisions should be reviewed to facilitate improved information sharing.

Recommendation 11: Increase information sharing between trade unions and others

- Information flows about harmful phoenix activity from and to trade unions should be improved.
- Superannuation law should be amended, and guidelines should be developed, to permit the proper exchange of information between trade unions and superannuation funds.
- ASIC should notify unions of the availability of the director disqualification and restriction registers and request that the unions notify ASIC if it comes to their attention that a disqualified or restricted director is continuing to manage corporations in breach of their disqualified or restricted status.

Recommendation 12: Provide corporate tax debt data to credit reporting agencies

- The government should continue to explore ways in which useful and accurate amounts of tax debt information could be released to credit reporting agencies.
- We note the government's announcement in the Budget 2016–17 Mid-year Economic and Fiscal Outlook that, from 1 July 2017, it will allow the ATO to disclose to Credit Reporting Bureaus the tax debt information of businesses that have not effectively engaged with the ATO to manage these debts.

Recommendation 13: Improve collection of statistical data about phoenix activity

- ASIC, the ATO, the FWO, and other relevant regulators and stakeholders should keep statistical data on the incidence and economic cost of phoenix activity – along with surveillance, investigation and enforcement actions they take in response to such activity – in order to accurately quantify the incidence and economic cost of phoenix activity and develop evidence-based laws, policies and practices that result in an effective reduction of harmful phoenix activity.

CHAPTER 2: DISRUPT HARMFUL PHOENIX ACTIVITY

Recommendation 14: Introduce restricted directorships

- A person who has been an officer of five corporations that have either failed (as currently defined in *Corporations Act* s 206D(2)) or been deregistered at ASIC's

instigation pursuant to *Corporations Act* s 601AB within the previous 10 years should automatically be subject to restriction for a period of five years.

- Any corporation of which a restricted director is a director or secretary should be deemed to be a restricted corporation.
- Where a restricted corporation fails during the restriction period, the period for which the director is restricted should be extended automatically until a date that is five years from the date of that failure.
- Restricted directors should be able to apply to the court for an order to set aside or vary the restriction.
- Director restriction should result in the following consequences:
    - the number of directorships a restricted director may hold at any given time should be limited to five;
    - restricted directors and restricted corporations should be subject to increased reporting requirements;
    - relevant regulators should prioritise restricted directors and restricted corporations when they are designing surveillance and inspection programs; and
    - consideration should be given to the possibility of allowing directors to reduce the length of their restriction or the conditions imposed upon them by voluntarily undertaking recognised education that helps them become more responsible and capable directors.
- Failure to comply with the requirements of restricted directorships should attract a fine of up to 100 penalty units or imprisonment for up to 2 years or both, and/or ASIC-ordered disqualification from managing corporations for up to 10 years.

Recommendation 15: Prioritise director disqualification in the phoenix context

- ASIC should prioritise the use of existing disqualification powers to disrupt and deter harmful phoenix activity.

Recommendation 16: Increase the maximum duration of ASIC disqualification

- The power of ASIC under s 206F of the *Corporations Act* to disqualify a person from managing corporations for up to five years should be amended so that ASIC has the power to disqualify a person from managing corporations for up to 10 years.

Recommendation 17: Give other regulators the power to seek disqualification orders

- The FWO should be empowered to seek court-ordered management disqualification where a person has contravened, attempted to contravene or been involved in a contravention of the *Fair Work Act* and the disqualification is justified.

- The ATO should be empowered to seek court-ordered management disqualification where a person has failed to discharge a duty under Division 269 of Schedule 1 of the *Taxation Administration Act* and the disqualification is justified.

Recommendation 18: Increase the penalties for managing companies while disqualified

- The penalties for managing companies while disqualified under the provisions of Part 2D.6 of the *Corporations Act* that do not require a judicial determination of wrongdoing (e.g. ss 206B(3)–(4), 206F, 206D) should be increased to a fine of up to 100 penalty units or imprisonment for up to two years, or both.
- The penalties for managing companies while disqualified under the provisions of Part 2D.6 of the *Corporations Act* that require a judicial determination of wrongdoing (e.g. ss 206B(1), 206C, 206E) should be increased to a fine of up to 4,500 penalty units or imprisonment for up to five years, or both.
- Section 206F of the *Corporations Act* should be amended to give ASIC the power to extend a disqualification period by up to 10 years if a person manages corporations while disqualified from managing corporations under Part 2D.6 of the *Corporations Act* and the extension is justified.

Recommendation 19: Check ABN applicants against restricted & disqualified registers

- On receipt of an application for an ABN, the ATO should check with ASIC whether the company's associates are restricted directors or disqualified directors.
- The ATO should report to ASIC where it has uncovered disqualified directors attempting to be involved in the management of a company so that ASIC may commence a prosecution under s 206A.
- The ATO should have the power to refuse to grant an ABN to a company which lists a disqualified director as an associate.
- In granting an ABN to a company which lists a restricted director as an associate, the ATO should be given the discretion to:
    - grant the ABN to the restricted company conditional upon the payment of a bond or the provision of security over an asset owned by the restricted director; or
    - grant the ABN unconditionally.

Recommendation 20: Introduce independent valuations of related party transfers

- In an action by ASIC or the liquidator for breach of directors' duty, there should be a rebuttable presumption that a related party transaction is not arm's length.
- The presumption would be rebutted by an independent valuation or such other evidence as the court considers appropriate.

- The operation of the presumption would be subject to a 12 month limit prior to insolvency and a $5,000 asset value limit to avoid the provision being too onerous on business.
- Definitions should be inserted for 'independent valuation' and 'related party'.

Recommendation 21: Limit the backdating of directorships

- Changes to directorships should only be able to be backdated up to three months.

Recommendation 22: Expand the Director Penalty Notice (DPN) regime

- The DPN regime in the *Taxation Administration Act* should be expanded to include GST liabilities.
- An equivalent to the DPN should be introduced in state taxation legislation across Australia.
- The DPN should be recognised as constituting only part of a wider suite of measures beneficial to the ATO to tackle harmful phoenix activity.

Recommendation 23: Require payment of tax and super via Single Touch Payroll

- 'Single touch payroll' which requires both reporting and payment of tax and superannuation obligations should be gradually introduced.
- If single touch payroll is not expanded as recommended, the proposal for automated DPNs should be re-considered.
- The ATO should ensure that DPNs are sent to all directors of companies which fail to remit PAYG(W) taxes and superannuation payments, to ensure that either the amounts are paid or these companies are promptly placed into external administration to avoid further losses accruing.

CHAPTER 3: PUNISH AND DETER HARMFUL PHOENIX ACTIVITY

Recommendation 24: Clarify the enforcement role of liquidators and increase funding

- The government needs to address the issue of adequate funding for liquidators to ensure that they can discharge their statutory duty to report properly.
- If liquidators are to be charged with the primary responsibility for investigating wrongdoing – in addition to their important enforcement role in bringing asset recovery actions – these investigatory responsibilities should be expressly stated in the *Corporations Act* and adequate funding should be provided.

Recommendation 25: Prioritise enforcement action in the phoenix context

- Regulators should prioritise taking enforcement action against persons who engage in unlawful conduct in the course of phoenix activity so as to reduce the prevalence and economic cost of harmful phoenix activity.

Recommendation 26: Improve public reporting of enforcement activity

- To improve the reporting of phoenix-related enforcement activity, regulators should:
    - using the UK Insolvency Service model, provide meaningful information about enforcement via media releases or websites to enhance specific deterrence and general deterrence (all regulators);
    - recommence publication of ASIC summary prosecution reports and add categories for the DIN and companies in connection with which the offence was committed (ASIC only);
    - report ATO aggregate statistics on DPNs annually and issue a media release announcing and explaining the statistics (ATO only);
    - report the identity of directors who fail to comply with DPNs, including their DIN and companies in connection with which the failure occurred (ATO only); and
    - collate and report data about enforcement in the phoenix context to enable reliable assessment of the efficacy of existing and newly introduced laws (all regulators).

Recommendation 27: Expand s 596AB of the Corporations Act

- Section 596AB should be amended to include a civil penalty provision, proved via an objective test, in addition to the criminal offence.

Recommendation 28: Increase the maximum penalties for breaches of directors' duties

- The maximum civil pecuniary penalty for an individual under s 1317G of the *Corporations Act* should be increased to $500,000.
- The maximum criminal fine for offences against ss 184, 588G(3) and 209(3) under Schedule 3 of the *Corporations Act* should be increased to 4,500 penalty units.
- Consideration should be given to introducing penalties that are a multiple of the benefit gained, to properly undermine the incentive to engage in illegal phoenix activity.

Recommendation 29: Increase the penalties for Fair Work Act individual liability

- Section 546 of the *Fair Work Act* should be amended to allow the court to impose the same penalty on an individual as it would on a company where the company has been placed into liquidation to avoid a penalty and other specified circumstances exist.

Recommendation 30: Remove the benefit of harmful phoenix activity

- Section 1317H of the *Corporations Act* should be amended to include an express power for the court to order Newco to compensate Oldco for gains it has made through the breach of duty of one of Oldco's directors.
- This power should depend upon Newco being an accessory to the breach of duty within the meaning of s 79 of the *Corporations Act* or being controlled by the person breaching the duty.
- In addition to amending s 1317H of the *Corporations Act*, ASIC should be given the power to seek disgorgement in civil penalty proceedings.

Recommendation 31: Clarify accessory orders under the Fair Work Act

- Section 545(1) of the *Fair Work Act* should be amended to include the words 'including a person involved in a contravention pursuant to s 550 of this Act'.
- In the context of an insolvent employer, any order of compensation payable by an accessory in respect of unpaid employee entitlements should be paid to the company's liquidator to avoid the possibility of double recovery.

Recommendation 32: Expressly address the role of advisors

- The government should consider whether it is possible and desirable to empower the courts to revoke, or impose conditions upon, professional licences where
    - an advisor is disqualified from managing corporations by the court, or
    - an advisor has been found to be an accessory to a director's breach of duty.
- ASIC should make greater use of the enforcement mechanism contained in s 79 to bring proceedings against both professional and other pre-insolvency advisors.
- To achieve effective deterrence, courts must impose meaningful penalties on pre-insolvency advisors found to be accessories to directors' breaches of duty.

1 DETECT ALL PHOENIX ACTIVITY

'Harmful phoenix activity' is phoenix activity that is either 'problematic' – i.e. technically legal but involving repeated resurrection of the business by inept entrepreneurs that is harmful to creditors and society – or 'illegal', as classified and explained in our first report, Defining and Profiling Phoenix Activity.[29] One of the main reasons harmful phoenix activity takes place is that it is difficult for those outside the company to know what is happening. A creditor might not know that the director of the company they are doing business with has a track record of running companies that do not pay their debts. Even ASIC and the company's liquidators may not be able to 'join the dots' sufficiently to determine whether the directors have engaged in a legitimate 'business rescue' – i.e. legal phoenix activity – or are breaching their duties to Oldco.[30] Serial inept entrepreneurs keep their heads down and are likely to escape notice.[31]

We think 'sunlight is the best disinfectant',[32] and the first step in dealing with harmful phoenix activity is to have *all* phoenix activity visible. To achieve this, we recommend greater transparency as part of incorporation and insolvency in general. Once information is obtained, it needs to be shared appropriately.

1.1 Assist all stakeholders to detect harmful phoenix activity

This part recommends two significant measures to improve transparency – issuing directors with a director identification number after verifying their identity, and changing the process for incorporating companies. This will assist all stakeholders to detect harmful phoenix activity, either to avoid becoming a victim of it or to assist in bringing legal action against it.

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29 For further explanation, see Executive Summary, above nn 1–7 and accompanying text.

30 The term 'Oldco' refers to the company that has been wound up or abandoned to avoid liabilities associated with Oldco, while 'Newco' refers to the company that has risen from Oldco's ashes: see Executive Summary.

31 Not all escape notice. An example is the case of Mr Quinlivan: 'Mr Quinlivan was disqualified due to his involvement in 14 companies that were wound up in insolvency between 2002 and 2007: National Consolidated Investments Pty Ltd, Coastal Administration Services Pty Ltd, Remi Morgan Burns Pty Ltd, Australian Financial Management Corporation Pty Ltd, Consolidated Property Investments Pty Ltd, Manorbase Pty Ltd, First Home Buyer (Aust) Pty Ltd, Ausblue Pty Ltd, Shellston Pty Ltd, Coventry Finance Pty Ltd, Rental Options Pty Ltd, Statefort Pty Ltd, Freedom Mortgages Pty Ltd and Scottsdale Homes No 10 Pty Ltd. In the period between ASIC's original decision to disqualify Mr Quinlivan and the hearing of the AAT review, further companies associated with Mr Quinlivan entered external administration. In light of these additional circumstances, ASIC expressed concern that Mr Quinlivan continued to be involved in large scale property developments and asked that the AAT disqualify Mr Quinlivan for five years.' See ASIC, 'High Court Dismisses Quinlivan Application to Appeal' (Media Release, 11-181MR, 23 August 2011).

32 The full quote and attribution to US Supreme Court Justice Louis Brandeis is given in Helen Anderson, 'Sunlight as the Disinfectant for Phoenix Activity' (2016) 34 *Company and Securities Law Journal* 257.

1.1.1 Director Identification Number (DIN)

All existing and new directors should be required to have a director identification number ('DIN') that would allow ASIC and other regulators to accurately track repeat players. This is our most important recommendation,[33] and it is key to many of the other recommendations in this document.

Repeat players might try to conceal their later directorships under the guise of a dummy director – an obliging relative perhaps – or a fictitious character, or their own name misspelt or a false date of birth. At present, the registration of an Australian company simply requires the name, address, and date and place of birth of each proposed officeholder.[34] ASIC's form[35] does not ask for the prior corporate history of its proposed directors, and no supporting evidence about the identity of the proposed directors is required. ASIC does not independently verify the information provided to it.

The limitations of the existing company registration requirements could be overcome through the relatively simple and cheap process of requiring directors to establish their own identity via 100 points of identity proof, which would accord with the well-accepted and uncontroversial practice for opening bank accounts and obtaining passports. Directors would then be allocated a unique DIN, which would enable tracking of company directors who have been involved in multiple corporate failures and who may be likely to engage in harmful phoenix activity. This would allow regulators to know that Frank Nadinic, Frane Nadinic and Frank Nadimic are the same person.[36]

Accurate identity information assists regulators in locating and monitoring those individuals against whom enforcement action might be taken.[37] This sort of identification, done solely based on names and dates of birth and their variants, and in the absence of a unique number,

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33 Note that a unique identity number was recommended by the Victorian Law Reform Committee in 1994: VLRC, *Curbing the Phoenix Company: First Report on the Law Relating to Directors and Managers of Insolvent Corporations*, Report No 83 (1994) recommendation 6, [3.3.11]. However, the Committee did not recommend that proof of identity should precede the issuing of a number. ASIC refers to a 'person number' in relation to its data matching program with the Australian Financial Security Authority ('AFSA') but this does not appear to be used as a mechanism for tracking directors and targeting abuse of the corporate form: ASIC, *Data Matching Program with AFSA* <http://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/data-matching-program-with-afsa/>.

34 *Corporations Act 2001* (Cth) s 117(2) ('*Corporations Act*').

35 ASIC, *Form 201: Application for Registration as an Australian Company* (11 December 2012, last updated 1 July 2014); *Corporations Act* s 117(4).

36 This true example was cited in *SERC Construction Insolvency Report*, above n 14, [12.31]. Mr Nadinic acknowledged registering 32 to 33 companies under these names.

37 Productivity Commission, *Business Set-up Report*, above n 16, 425: 'The Commission considers that rather than crafting new offences, improvements in the detection and enforcement of existing laws are likely to be the best option for creating a genuine disincentive for directors contemplating phoenix action.'

is expensive and extremely time-consuming. A unique DIN, on the other hand, clearly differentiates people and makes them easy to identify. A computer prompt could tell ASIC that a person's DIN has been used for the directorships of dozens of companies that the person is unlikely to be managing or supervising in compliance with their legal obligations.[38] The DIN would also assist other regulators to perform their functions better, and this is discussed further at [1.3.2]. For example, the DIN could alert the ATO to potential wrongdoing where an elderly person with no assessable income is the director of numerous companies.[39] The advantages of a DIN are obvious for agencies such as the Australian Criminal Intelligence Commission (a merger of the Australian Crime Commission and CrimTrac as of 1 July 2016) and the Australian Federal Police, who are seeking to identify and monitor those associated with organised crime[40] and complex illegal phoenix activity.[41]

The DIN should also be widely circulated.[42] For example, employees should be provided with the DIN of the directors running the employer company on commencement of employment, in the same way that they are provided with the National Employment Standards. Potential creditors should either be provided with the DINs of the company's directors on quotes or other paperwork, or they should be directed towards a company website that contains this information. A duty could be imposed on directors to keep it current.

In its final report released in December 2015, the Productivity Commission recommended adoption of the DIN both for new and existing directors,[43] noting broad support for the

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38 For example, their duties as directors under *Corporations Act* pt 2D.1.

39 See, eg, Australian Broadcasting Corporation ('ABC'), 'Unwitting Clients Signed up as Directors to Failing Businesses', *7.30 Report*, 17 October 2016 (Dan Oakes). The Australian Taxation Office ('ATO') does obtain identity information from 'associates' – those seeking an Australian business number ('ABN') for a company – but this information is not linked to any other company that those associates own or control.

40 See, eg, Australian Crime Commission, *Organised Crime in Australia* (May 2015) 8, 25–6, 65–6.

41 In addition to combatting organised crime and illegal phoenix activity, the DIN would assist in disrupting other forms of financial and corporate misconduct, like the notorious series of alleged incidents involving Mr Philip Whiteman: see Dan Oakes and Sam Clark, *Melbourne Man Identified in Multi-Million Dollar Tax Evasion Investigation Still in Business* (7 February 2017) ABC News <http://www.abc.net.au/news/2017-02-06/melbourne-man-linked-to-tax-avoidance-still-in-business/8244850>; ABC, above n 39; Oakes and Clark, below n 329; Russell, below n 330.

42 Note that our DIN recommendation is separate from the debate about revealing, or concealing, the director's home address and date of birth. It has been suggested that this facilitates identity theft: see the concerns of Governance Institute of Australia discussed in Productivity Commission, *Business Set-up Report*, above n 16, 428. We pass no opinion on whether the current process whereby directors' home addresses are available publicly if a fee is paid should be maintained or not. The Irish *Companies Act 2014* has changed address disclosure requirements to enable an officer in specified circumstances to request that their residential address not be shown on the register of companies: *Companies Act 2014* (Ireland) s 150(11); *Companies Act 2014 (Section 150) (No. 2) Regulations 2015* (Ireland).

43 Productivity Commission, *Business Set-up Report*, above n 16, recommendation 15.6. Note that the Productivity Commission also endorsed the Director Identification Number ('DIN') in its report, *Workplace Relations Framework*, Report No 76 (2015) vol 1, 48, vol 2, 915, 938.

concept, even from directors themselves.[44] Countries as diverse as India[45] and Estonia[46] have director verification procedures, and the DIN is a policy position of the Australian Restructuring Insolvency and Turnaround Association ('ARITA').[47] A DIN was also supported by the Senate Economics References Committee's inquiry into insolvency in the construction industry.[48]

There is not yet any response from the government about the DIN recommendation. However, the Treasury file titles document for the spring sittings 2016[49] contains an item titled '2016MG-90-15087 Markets Regulation - Policy Formulation - Corporations - DIN'.[50] This suggests that the government may be in the process of preparing a response to the Senate committee and Productivity Commission recommendations to establish a DIN.

In the event that the recommendation of a DIN is adopted, it must be adequately resourced. ASIC is in favour of checking the identity of directors,[51] and broadly supported the idea before the Productivity Commission[52] but sounded this warning:

> ASIC is concerned, however, about the cost of implementing this draft recommendation and how it would work in practice. It would be extremely costly to build a stand-alone authentication process and implement it across our technology and services. ASIC would need to modify registers, portals, machine to machine services with software developers etc. Further, most registrations (over 90%) are made via

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44 Productivity Commission, *Business Set-up Report*, above n 16, 426.

45 See Ministry of Corporate Affairs, Government of India, *Apply for DIN* <http://www.mca.gov.in/MinistryV2/applyfordin.html>.

46 Estonia offers corporate e-residency which is a form of digital identification. It requires directors to provide identity card information which has already verified the person's identity: see Republic of Estonia, Government, *Estonia Opens its E-services to the World* <https://valitsus.ee/en>; <https://e-estonia.com/e-residents/about/>.

47 Australian Restructuring Insolvency and Turnaround Association, *Policy Positions of the Australian Restructuring Insolvency and Turnaround Association* (February 2015) policy 15-05.

48 *SERC Construction Insolvency Report*, above n 14, recommendation 36, [12.38] (DIN), recommendation 37, [12.39] (proof of identity). Recommendation 38 called for the *Australian Securities and Investments Commission Act 2001* (Cth) to be amended to require ASIC to verify company information.

49 Treasury (Cth), *Departmental and Agency File List* <http://www.treasury.gov.au/About-Treasury/OurDepartment/Departmental-and-Agency-File-List>. This document lists files created by Treasury between 1 January 2016 and 30 June 2016 in accordance with the Senate Order for the production of indexed lists of departmental and agency files.

50 See Treasury (Cth), *Treasury File Titles – Spring Sittings* <http://www.treasury.gov.au/About-Treasury/OurDepartment/Departmental-and-Agency-File-List/Spring-sittings>.

51 ASIC, Submission No 32 to Senate Economics References Committee, *Inquiry into Corporate Tax Avoidance*, February 2015, 21. The SERC agreed, recommending that 'people who propose to become directors of companies be required to provide evidence of their identity to the ASIC': Senate Economics References Committee, Parliament of Australia, *Corporate Tax Avoidance (Part I): You Cannot Tax What You Cannot See* (2015) recommendation 16, [6.75] ('*SERC Corporate Tax Avoidance Report*').

52 ASIC, Submission No DR 58 to Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, July 2015, [55]–[59].

> third party agencies.[53] Any reform proposal would need to develop a solution for effecting identification checks by third parties. Finally, ASIC could not support in-person interactions at our offices. If we could not collect 100 points of identity proof on-line it may be necessary to engage a third party like Australia Post to perform this function.[54]

Some or all of the costs associated with the implementation of this recommendation could be ameliorated if the DIN were introduced as a user pays system. Directors registering for the DIN for the first time could be required to pay a one-off fee to cover or subsidise the cost of the service. The benefits of incorporation are so significant for business people that the relatively small cost of obtaining a DIN is highly unlikely to discourage any potential entrepreneurs from incorporating a company. If potential directors do not have the financial means to pay a small amount for a DIN, it is unlikely that they are in a position to embark on a new business.

The DIN proposal is not to be confused with the Coalition Government's 'streamlining business registration' initiative.[55] It was announced under the *Growing Jobs and Small Business* package that the government would develop a single online portal for business and company registration and establish a single business identifier.[56] The underlying requirements for various registrations would not change; rather, a single portal would accommodate multiple registrations, such as for business names, goods and services tax ('GST') or fringe benefits tax ('FBT').

ASIC seemed concerned about overlapping projects in its response to the Productivity Commission:

> In light of these concerns, we do not believe that ASIC should develop a stand-alone identity authentication service. Indeed it would be inconsistent with the work being undertaken by the Digital Transformation Office to develop a Trusted Digital Identity Framework ('the Framework') to support the government's Digital Transformation Agenda. We understand the Framework will involve establishing a common strategic approach to identity across government and preventing agencies from investing in

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53 We recommend that the government review the desirability of business service providers selling aged shelf companies: see [1.1.2]. However, our DIN proposal could accommodate third party registration.

54 ASIC, above n 52, [57].

55 See Australian Government, Business.gov.au, *Streamlining Business Registration* <https://www.business.gov.au/for-government/Streamlining-business-registration>.

56 Ibid. The *Streamlining Business Registration* website notes that '[t]he Government is considering the findings of an implementation study which assessed the economy-wide impacts of adopting a single business identifier. If the Government proceeds with a single business identifier, the Australian Business Number (ABN) may replace Australian Company Numbers (ACNs) for new company registrations, and replace non individual Tax File Numbers (TFNs) for other non-individual businesses. A single business identifier may remove the need for businesses to use multiple identifiers with government.'

bespoke solutions. This will mean that individuals and businesses will no longer have to prove their identity multiple times to government when accessing services.[57]

Here we stress the difference between the DIN *for the purpose of individuals incorporating companies*, which is what we are proposing, and a single identifier for businesses and *for individuals conducting businesses as individuals*, as proposed by the Trusted Digital Identity Framework.[58] We agree that a plethora of numbers – ACNs, ABNs, tax file numbers, Auskey numbers – adds to the cost of doing business, and we support measures to reduce these. But the DIN process, while it could be added to the Trusted Digital Identity Framework, has a distinct and separate justification. We urge the government not to lose sight of the significance of proving directors' identities *before* allowing them to incorporate companies that are then allocated a Trusted Digital Identity.

To be effective, DIN information needs to be connected to companies being newly incorporated, existing companies already managed by the director, and deregistered companies with which the director has been associated. The first is dealt with at [1.1.2]. The second could be achieved by the directors of existing companies being required to provide their DIN as part of the completion of the annual review process[59] or annual reporting.[60] The third – information about associations with previously deregistered companies – could be required from directors as part of the process of obtaining DINs.[61] A penalty for false statements would apply, as it does to all other documents lodged with ASIC.[62]

A director's DIN, like a company's ACN, would be publicly available and searchable. That is the point of it. To ensure that wrongdoers do not steal someone else's DIN and utilise it for incorporating companies, it needs to be password protected. Any ASIC lodgement requiring the DIN should require the use of the password.

Recommendation 1: Require directors to obtain a Director Identification Number

- Directors of companies should be required to obtain a director identification number ('DIN') after proving their identity with 100 points of identification.
- At the time of annual reviews or annual returns for existing companies, directors

57 ASIC, above n 52, [58].

58 See Australian Government, Digital Transformation Agency, *Trusted Digital Identity Framework* <https://www.dta.gov.au/what-we-do/budget/trusted-digital-identity-framework/>.

59 *Corporations Act* ch 2N.

60 Ibid ch 2M.

61 For example, directors could be asked: 'Have you ever been a director or other officer of a company that has been deregistered either with or without being liquidated? If so, please provide the registered company name (if applicable) and Australian Company Number (ACN) of every company of which you have been a director or other officer that has been deregistered either with or without being liquidated.'

62 *Corporations Act* s 1308(2).

should be required to quote their DIN.

- In relation to previously deregistered companies, directors should be required to provide information about these companies as part of the process of obtaining a DIN.
- A penalty should apply for omitted or incorrect information.
- The DIN should be password protected for directors' interactions with regulators.
- Like a company's ACN and ABN, the DIN should be visible to the public, and, in particular, prospective employees and creditors, via the company's documentation or website, to enable searches of the director's prior corporate history.
- Directors should be subject to a duty to keep company documentation and websites current regarding their DIN.
- A small charge should be levied on prospective directors applying for a DIN to help defray the cost of implementing the system.

1.1.2 Changes to the process for incorporating companies

The incorporation process can be useful in detecting the creation of companies being set up to engage in harmful phoenix activity. The DIN, used as part of the company registration process, would provide significantly more information to ASIC than the present paper form does. An online application system, completed by the applicant, is the most efficient. The United Kingdom is moving to an online system.[63] Directors with existing and previous directorships would cite their DIN and the incorporation application form would pre-populate with those details. If our suggestion above – that directors of existing companies should be required to quote their DIN at the time of companies' annual reviews or annual returns – is adopted, it should only take one annual cycle for the system to accumulate this information. First-timers would have little to complete after giving their DIN.

The aim here is to equip ASIC with information about this person, allowing the regulator to take appropriate action which may include placing them on a watch list or identifying that they have become a 'restricted' director. Director restriction is a new protective mechanism that we recommend introducing in relation to directors who have been involved in five or more corporate failures within the previous ten years (see [2.1] for further discussion).[64] An equally important aim is to alert the would-be director to the fact that *ASIC has this information at its fingertips*. They, and their previous corporate histories, are not invisible.

[63] In the UK, the *Small Business, Enterprise and Employment Act 2015* (UK) requires the Secretary of State to provide, by 31 May 2017, a streamlined incorporations process, which can be completed online on a single occasion: s 15

[64] Note that ASIC already obtains information about liquidated companies, including unmet taxation liabilities and amounts owed to employees and other creditors, through the reporting of external administrators. This is discussed further at [1.2.2].

Directors would be required to supply any missing information, and if this is false, they may be prosecuted.[65] All of this director and incorporation information would add to the intelligence that ASIC could share with other government agencies.

At present, to register a company, a prospective director must either complete Form 201 and mail it to ASIC with appropriate payment, or must transact through a business service provider who uses software to deal directly with ASIC.[66] This may involve the purchase of an aged 'shelf' company that the business service provider has already registered. Our suggestion that the prospective director complete the online form themselves, or with the assistance of someone else, would eliminate the need for the purchase of already-incorporated companies from shelf company providers.

In our opinion, this is a good thing. In the past, when incorporation involved weeks of delay while forms were being processed, it made sense to be able to acquire an existing company immediately. However, those days have passed, as a company can now be created online within an hour. We question why aged shelf companies continue to be used. According to AUSeCorporate,

> Buying a shelf company provides a number of advantages over newly incorporated companies, making them an attractive solution for many clients. These advantages include:
>
> - Increased Business Partner Confidence – older shelf companies project a greater sense of confidence to potential business partners or clients who feel more comfortable dealing with an established company.
> - Access to Restricted Services – Some licensed services require a company to be in business for a certain length of time in an applicable industry in order to be eligible.
> - Improved Credit Options – Banks or financial service providers sometimes hesitate to open bank accounts, provide merchant facilities, or offer credit to new companies. Buying an aged shelf company can rectify this and provide enhanced credit opportunities, allowing for increased borrowing power.
> - Favourable for Immigration Purposes – Used and aged companies are of far greater advantage for Australian immigration purposes, which sometimes require a company to have been in business for several years.

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65 *Corporations Act* s 1308(2), sch 3 item 335.

66 See ASIC, *Starting a Company – How to Start a Company* <http://asic.gov.au/for-business/starting-a-company/how-to-start-a-company/>.

- Contract Tendering Eligibility – some jurisdictions have strict requirements for tendering, requiring companies to be in business for a period of time before they can be eligible to bid on a contract.[67]

We question the terminology used above, such as companies being 'in business for a period of time' or 'an established company', when the companies themselves are quoted as 'never traded'.[68] Shelf companies are also used in other jurisdictions, and for the same sorts of purposes, such as '[t]o create an appearance of corporate longevity, which may boost investor or consumer confidence.'[69]

In addition to questioning the utility of aged shelf companies, we also have concerns that they may make it more difficult for regulators to use data analytics to identify companies that are engaged in, or at risk of engaging in, harmful phoenix activity. In cases of cyclical phoenix activity – i.e. where Oldcos are repeatedly liquidated or abandoned to shed debts as part of an ongoing 'business model' – the Oldcos will not usually have a long incorporation age. If a shorter incorporation age is used as one of the parameters for searching regulator databases for 'at risk' companies, aged shelf companies may not be captured by the search. A savvy phoenix operator could use shelf companies of varying ages to create the impression that each company that fails is an established, independent company that has failed due to unforeseen circumstances, rather than as part of a deliberate pattern of fraudulent behaviour. While the introduction of a DIN [1.1.1] would go a long way toward identifying this kind of systematic abuse of the corporate form, we think that aged shelf companies pose an unnecessary risk of making it easier to engage in harmful phoenix activity.

Some would-be company directors might feel more comfortable with some assistance from a business services provider in incorporating a company (although we question whether such a person will have the aptitude to run a company in today's digital environment and to interact with ASIC and the ATO electronically as they will be required to do). Where a business services provider is used, the director should still be required to acquire and provide their DIN. Where an existing trading company is purchased, the DIN would be required to be

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67 AUSeCorporate, *Australian Pre-registered Company* <http://www.ausecorporate.com.au/corporate-services/australian-shelf-company/>. See also David Garry & Associates, *Aged Shelf Companies* <https://www.davidgarry.com.au/services/aged-shelf-companies.html>: 'Sometimes the incorporation age is a consideration in presenting longevity.'

68 AUSeCorporate, ibid.

69 Formacompany Worldwide Incorporations, *Advantages of a Shelf Company* <http://www.formacompany.com/en/advantages-of-shelf-company.php>. See also Hero Ventures, *Old Ready Made Shelf Companies List – Previously Registered* <http://www.readycompanies.com/ShelfCompanies.htm>; Coddan, *Buy a Shelf Company (Off-The-Shelf Company) from Coddan* <https://www.coddan.co.uk/ready-made-off-the-shelf-companies/>.

stated on the 'notification of change to directors' form.[70] However, we think that the government should review the desirability of business service providers selling aged shelf companies, as it is unclear whether they continue to serve any beneficial policy objective and we are concerned that they may increase the risk of systematic harmful phoenix activity by thwarting regulators' data analytics.

Recommendation 2: Make the process for incorporating companies more transparent

- The process of incorporation should be online with the prospective directors quoting their DINs.
- The DIN should be quoted for changes of directorship within existing companies.
- While the DIN should enable the application form for registration as an Australian company to pre-populate with previous incorporation history, directors should be required to supply missing information.
- The government should review the desirability of business service providers selling aged shelf companies.

1.2 Assist external administrators to detect harmful phoenix activity

External administrators are at the front line of the detection of harmful phoenix activity, closer even than ASIC. It makes sense to assist them as fully as possible.

When companies have financial troubles, external administrators play key roles. Receivers step in to protect secured assets. Voluntary administrators try to save the company or its business, to maximise returns to creditors. Liquidators finalise the affairs of the company, investigate whether they can recover property for the benefit of creditors, then distribute the company's remaining assets.

Each of these roles also involves a statutory report to ASIC. Later in this report, enforcement and recovery actions that external administrators can take are discussed but here we concentrate on the role that external administrators can play in relation to detecting harmful phoenix activity and sharing that information. Our recommendations would necessitate a significant overhaul of a number of existing processes relating to investigations and reporting by liquidators. In our view, the effort will be well rewarded and the overhaul is long overdue.

[70] ASIC, *Form 490: Notification of Change to Directors of a Registered Body* (17 January 2011, last updated 1 July 2014); *Corporations Act* s 601CV(1)(c).

1.2.1 Report as to Affairs (RATA)

The lack of information provided to liquidators in Reports as to Affairs ('RATAs')[71] and the failure of directors to provide RATAs and company records are significant hindrances to the detection of harmful phoenix activity. In this part of the report we recommend measures aimed at ensuring that liquidators receive the information they need to conduct the liquidation, investigate and report any misconduct to ASIC and take legal action on behalf of the company's creditors where required.

1.2.1.1 Revise the contents of the RATA

Early in a liquidation, the liquidator asks the directors to provide books and records,[72] and to supply a RATA. These two requests are designed to provide the liquidator with the information needed to begin the liquidation.

The RATA asks about the company's assets and liabilities and assists the external administrator in gathering in the company's property and paying off its creditors. At present, the RATA is a very limited document.[73] It does not ask any questions about previous company failures with which the director has been associated. This is a missed opportunity for the liquidator to become aware of facts which might encourage further investigation and an application to the Assetless Administration Fund.[74] It also does not ask about whether the director is currently managing any other existing company. This may alert the liquidator to harmful phoenix activity if the director is involved with the company to which Oldco's assets have been sold.

If the DIN measure is implemented, the RATA process should be revamped as follows. Upon accepting the liquidation engagement, the liquidator would notify ASIC. ASIC would then provide the liquidator with a pre-populated RATA that already contains information about the director and their previous and existing directorships. This measure would substantially increase the information available to liquidators, and it has the potential to improve the performance of their duties and reduce their costs.

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71 *Corporations Act* s 475(4); ASIC, *Form 507: Report as to Affairs* ('RATA') (30 January 2012, last updated 1 July 2014).

72 *Corporations Act* s 530A(1).

73 See Explanatory Memorandum, Insolvency Law Reform Bill 2015 (Cth) [9.335], [9.345]–[9.347], [9.350].

74 The Assetless Administration Fund ('AAF') is administered by ASIC. With funds provided by the government, it finances insolvency practitioners in their work on behalf of companies with few or no assets. The aim of the fund is to overcome the inability of liquidators to make proper investigations due to financial constraints. 'A particular focus of the AA Fund is to curb fraudulent or illegal phoenix activity': ASIC, *Regulatory Guide 109: Assetless Administration Fund – Funding Criteria and Guidelines* (November 2012) [109.6] ('*ASIC Regulatory Guide 109*').

Providing liquidators with this information, and giving it to them for free, is vital. Because liquidators have professional obligations of independence,[75] they are not familiar with the prior corporate history of the directors who engage them to wind up their insolvent companies. At present, liquidators winding up a phoenix company must pay ASIC[76] to obtain documents about the company and its directors, in order to perform their statutory obligation to report *to* ASIC about director misconduct. This seems entirely the wrong way around. Liquidators should be provided by ASIC at no cost with as much information as possible, at the commencement of the engagement, to ensure that the liquidators can perform their gatekeeper roles efficiently and effectively.

After receiving the pre-populated RATA, the directors would then be obliged to provide additional information relating to the present company and its demise, and to fill in any information gaps relating to previous company failures. As at present, the form would ask for details of assets and liabilities, but a revised form would also ask for details of significant asset transfers by the insolvent company within the past 12 months. We recommend, at [2.4], that there be independent valuations of asset transfers to related parties. The existence of these transfers would be disclosed in the RATA and the valuation would be appended.

At the start of 2015, ASIC contracted an independent consultant to obtain expert feedback on the RATA. During the consultation process, changes were suggested by various parties and issues arose about whether providing additional information in the RATA might breach privacy restrictions. The RATA is a public document once lodged.[77] To accommodate changes to the RATA, the *Insolvency Law Reform Act 2016* amended[78] s 1274 of the *Corporations Act* by adding sub-s 4D, to allow ASIC to 'edit from a statement of affairs[79] any information that ASIC is satisfied is commercial-in-confidence, before allowing a person to inspect the statement, or giving a copy or extract of the statement to a person …' Subsection 4F provides that:

> (4F) Information is ***commercial-in confidence*** if:
>
> (a) the disclosure of the information could unreasonably affect a person, or a business or action related to a person, in an adverse manner; and
>
> (b) the information is not in the public domain; and

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75 Australian Restructuring Insolvency and Turnaround Association, *ARITA Code of Professional Practice* (3rd ed, 2014) ch 6.

76 Under s 4 of the *Corporations (Fees) Act 2001* (Cth), the definition of 'chargeable matter' includes: '(c) the inspection or search of a register kept by, or a document in the custody of, ASIC …'; and '(d) the making available by ASIC … of information (whether in the form of a document or otherwise).' The fee charged does not need to bear any relationship to the cost of providing the service: s 6(2).

77 *Corporations Act* s 1274.

78 *Insolvency Law Reform Act 2016* (Cth) sch 2 item 216 ('*Insolvency Law Reform Act*').

79 *Corporations Act* s 1274(4E) includes a RATA prepared under ss 475(1)–(2).

(c) the information is not required to be disclosed under another law of the Commonwealth, a State or a Territory; and
(d) the information is not readily discoverable.

ASIC expects to release the new RATA document in June 2017. As a result, at the time of writing we cannot comment on what RATA information will be for ASIC's and the liquidator's eyes only, and what will be on public display.

We strongly support liquidators being given whatever additional information would assist them in detecting phoenix activity so that they or ASIC may take action where appropriate. This valuable opportunity to obtain information from directors of failed companies should be utilised more fully.

Recommendation 3: Provide additional information in reports as to affairs (RATA)

- ASIC should supply pre-populated RATA documents to liquidators containing information held by ASIC.
- There should be no cost to liquidators for the information contained in the pre-populated document.
- The RATA form should be amended to require additional information about:
  - the directors;
  - previous company failures with which the directors have been associated; and
  - significant asset transfers by the insolvent company within the past 12 months.

1.2.1.2 Increase the penalty for RATA failures and books and records failures

The penalties for failure to provide a RATA, or failure to provide accurate and adequate information in the RATA, under ss 475(1)–(3) of the *Corporations Act* are too lenient. The statutory maximum penalties are a fine of 25 penalty units (currently $4,500)[80] or imprisonment for six months, or both.[81] In practice, prison sentences are very rarely imposed for offences under s 475.[82] As noted below with a failure to provide books and records, a

[80] *Crimes Act 1914* (Cth) s 4AA. The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

[81] *Corporations Act* s 475, sch 3 item 130. The *Insolvency Law Reform Act 2016* (Cth) has amended the penalties for offences under s 475 so that breaches of sub-s 475(4) – i.e. for submitting a RATA later than 14 days after the winding up order – attract a higher maximum fine of 50 penalty units but no option of imprisonment, while the penalties remain the same for offences under the other subsections in s 475: at sch 2 pt 2 item 263.

[82] See Keenan, below n 88 and accompanying text.

small fine is worth enduring for someone determined to thwart the investigations of a liquidator. Liquidators are not required to perform work for which they are not paid, beyond their bare reporting requirements: [3.1].[83] Every hurdle placed in a liquidator's way diminishes their ability to perform their gatekeeper function. Therefore, the penalty for RATA failures should be more severe. The possibility of it warranting disqualification was mooted in the explanatory memorandum to the *Insolvency Law Reform Act 2016* (Cth).[84] This should be considered again.

It is also an offence for a director to fail to provide books and records to a company's external administrator at the commencement of the administration.[85] However, the fine is lenient – up to $9,000.[86] Where illegal phoenix activity has occurred, books and records are likely to reveal evidence of insolvent trading or transfer of assets for an undervalue. Without this information, external administrators are unlikely to receive funding from the Assetless Administration Fund to carry out an investigation that could result in court action against the directors for breach of duty, which would result in far more severe penalties.

We understand that there is a concern that directors engaged in illegal phoenix activity are deliberately failing to provide books and records; the small fine of up to $9,000 is seen as the 'cost of doing business', in order to avoid the risk of an investigation and greater penalties. Particularly concerning is that the fines actually imposed rarely come anywhere near the maximum. A study published by the Australian Institute of Criminology in February 2013 found that 80% of successful summary prosecutions by ASIC[87] were for breaches of ss 475 and 530A of the Corporations Act, while 96% of all prosecutions resulted in fines, at an average of just $917.85 per fine.[88]

The penalties for failure to provide books and records to external administrators should be increased substantially to deter the destruction of books and records. External administrators

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83 *Corporations Act* s 545.

84 See Explanatory Memorandum, Insolvency Law Reform Bill 2015 (Cth) [9.331]–[9.334], [9.341]–[9.344], [9.350]–[9.355].

85 *Corporations Act* ss 438B (voluntary administration), s 530A (liquidation).

86 *Corporations Act* sch 3 item 134. Offences under ss 438B and 530A can also be punished by imprisonment for up to one year, but in practice prison sentences are very rarely imposed for such offences: see Keenan, below n 88 and accompanying text.

87 For an explanation of ASIC's summary prosecution power, see below n 303.

88 Peter Keenan, 'Convictions for Summary Insolvency Offences Committed by Company Directors' (Report No 30, Australian Institute of Criminology, February 2013) 4–6. Based on our analysis of data contained in ASIC's summary prosecution reports, enforcement reports and annual reports, along with the Commonwealth Director of Public Prosecution's ('CDPP') annual reports, it is estimated that ASIC carried out approximately 6,742 summary prosecutions in the 18-year period from 1 July 1997 to 30 June 2015, at an average of 375 per year. The frequency of these prosecutions arguably suggests that the penalties for failing to inform and assist liquidators are not sufficiently substantial to deter such misconduct.

must be equipped with the information they need in order to assess the merits of further investigation and to substantiate applications for funding.

Recommendation 4: Increase the penalties for failing to inform and assist liquidators

- The penalty for a failure to provide books and records should be substantially increased.
- The penalty for failure to provide a RATA or failure to provide accurate and adequate information in a RATA should be substantially increased.

1.2.2 External administrator reporting

Improved reporting by external administrators at the conclusion of their engagements has the potential to significantly improve the quality and quantity of information about harmful phoenix activity which is available to ASIC and to other regulators, if information is shared as we recommend below that it should be. Expanded external administrator reports also make it clear to the failed companies' directors and administrators that ASIC will be armed with the information to take action in appropriate circumstances.

The *Corporations Act* requires liquidators to report a number of matters to ASIC.[89] A central part of this reporting relates to misconduct by those managing companies before and during external administrations. External administrators notify ASIC whether they suspect the conduct breaches civil penalty or criminal laws and whether they hold documentary evidence to support their claims.

At present, external administrators' statutory reports ('EXAD reports') are 'tick box' reports,[90] processed by computers. They do not include a question about whether phoenix activity is suspected. This should be remedied. This suggestion was expressly endorsed by the Senate Economics References Committee's ('SERC') Construction Insolvency Report in 2015.[91] The SERC, considering ASIC's performance in 2014, also recommended a system by which external administrators could indicate to ASIC which reports required 'the most urgent

[89] This reporting is done in compliance with ASIC, *Regulatory Guide 16: External Administrators – Reporting and Lodging* (July 2008) ('*ASIC Regulatory Guide 16*').

[90] Ibid. The form completed by the external administrator is ASIC, *Form EX01: Schedule B of Regulatory Guide 16 – Report to ASIC under s422, s438D or s533 of the Corporations Act 2001 or for Statistical Purposes* (13 January 2016).

[91] *SERC Construction Insolvency Report*, above n 14, recommendation 11, [5.34]: 'The committee recommends that ASIC, in consultation with ARITA, work out a method whereby external administrators can indicate clearly in their statutory reports whether they suspect phoenix activity has occurred. For example, to serve as a red flag to ASIC, include a box in the reporting form that external administrators would tick if they suspected phoenix activity.'

attention and investigation'[92] but this recommendation was simply 'noted' by the government, with the claim that ASIC 'has worked, and continues to work' on this.[93] We believe this deserves immediate attention, as the SERC's report outlined 10 pages of complaints about ASIC's response to reports of misconduct[94] following which the committee stated that it 'received many other complaints [about ASIC] that are too numerous to detail here.'[95]

The EXAD reports should also provide some space in which ASIC can be advised of the specific details of phoenix activity and any other relevant information about the company and its directors.[96] Clearly, this would necessitate a move away from the automated processing[97] of the reports of misconduct that sees 89% '[a]nalysed and assessed for no further action' and only 11% followed with an automated request for a '[s]upplementary report'.[98]

These reforms would be easy to implement with online reporting. For example, where a box had been ticked to indicate that phoenix activity[99] was suspected, an additional box could appear inviting the external administrator to make comments.

Online reporting now takes place in the United Kingdom. Online reporting for external administrators commenced in 2016 and the online form expands depending upon the boxes ticked by the external administrator. From 6 April 2016, insolvency practitioners and official receivers must submit director conduct reports to the Insolvency Service (via the online reporting service) within three months from the date of appointment. The report must describe any conduct which may assist the Insolvency Service in deciding whether it is in the public interest to apply for the making of a disqualification order against a director.[100]

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92 Senate Economics References Committee, Parliament of Australia, *Performance of the Australian Securities and Investments Commission* (2014) recommendation 17, [15.66] ('*SERC Performance of ASIC Report*').

93 Australian Government, *Australian Government Response to the Senate Economics References Committee Report: Performance of the Australian Securities and Investments Commission* (October 2014) 9.

94 *SERC Performance of ASIC Report*, above n 92, 227–36.

95 Ibid [15.38].

96 See *ASIC Regulatory Guide 16*, above n 89. In December 2014, Form EX01 was changed to ask for additional information where insolvent trading was alleged. No amendment was made with respect to phoenix activity.

97 Australian National Audit Office, *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001*, Audit Report No 18 (2006–07) [2.7]–[2.12].

98 ASIC, above n 11, 95. See also Australian National Audit Office, ibid, [3.1]–[3.13]. It appears the situation has not changed since 2007: see *SERC Performance of ASIC Report*, above n 92, [15.60]–[15.63].

99 Although definitions of 'phoenix activity' vary to some extent, we think that most external administrators would be familiar with the broad concept of phoenix activity. However, if ASIC were to receive a significant number of EXAD reports indicating a lack of understanding about the mechanics of phoenix activity, it may need to consider providing a basic definition of 'phoenix activity' in EXAD reports.

100 Section 107 of the *Small Business Enterprise and Employment Act 2015* (UK) inserted a new section 7A into the *Company Directors Disqualification Act 1986* (UK).

ASIC could use the collated EXAD data to build profiles of directors who may warrant further action. Identified via their DINs, ASIC's database could collate the numbers of failed companies with which each director was associated. This detailed collection of information enhances the likelihood of successful enforcement action by ASIC and other regulators.

Given the concerns about the involvement of pre-insolvency advisors, discussed at [3.5], it also makes sense for external administrators to be able to tick a box to indicate that the company's directors had previously received advice from a pre-insolvency advisor. This would enable regulators to start to build an evidence-based understanding of the scale and workings of the pre-insolvency advice industry, which is currently unknown.[101] The first step in being able to better regulate pre-insolvency advisors' involvement in phoenix activity is to obtain accurate empirical data about the industry.

Recommendation 5: Collect additional information via external administrators' reports

- EXAD Reports should be amended to include:
  - a question about whether phoenix activity was suspected;
  - a question about the involvement of pre-insolvency advisors;
  - some space in which liquidators can advise ASIC of the specific details of phoenix activity and any other relevant information about the company and its directors; and
  - a method by which external administrators could indicate to ASIC which reports required 'the most urgent attention and investigation'.

1.3 Assist regulators to detect harmful phoenix activity

This part makes recommendations about the gathering of information about harmful phoenix activity by regulators. Improvements need to be made to:

- the methods by which information is obtained from the public; and
- the way that information is shared – both raw data and suspicions about offences – amongst regulators.

Regulators such as ASIC, the ATO and the FWO become aware of harmful phoenix activity through different means. The reports prepared by external administrators at the conclusion of

[101] According to the ATO's national director on phoenix enforcement, Michael Seddon: 'When it comes to pre-insolvency advisors, they are just an unknown for us. They're unregulated and they're unseen until we actually become the victim of it. Our common ways of actually running into these people are really through liquidators, registered tax agents and their clients. Going forward, it would be far more effective if we were able to deal with this particular industry at a known population level': ARITA, 'Pre-insolvency Advisors Behaving Badly: The Profession's View' (2016) 28(3) *Australian Restructuring, Insolvency & Turnaround Association Journal* 15, 16.

an insolvency engagement are ASIC's main source of information. The ATO, as a creditor itself, becomes aware of unremitted taxes through their own administrative processes. The ATO also conducts pro-active surveillance in relation to phoenix activity. The Fair Work Ombudsman's inspectorate, which deals with a broad range of matters covered by the *Fair Work Act*, may come across harmful phoenix activity. However, each also receives complaints from the public. In the case of the ATO, it receives complaints from the public with respect to superannuation payments which have not been remitted to the employees' own funds.

1.3.1 Complaint mechanisms and website information

The general public – victims of phoenix activity or otherwise – are a valuable source of information for regulators and other government agencies. Regulator websites need to contain better information about harmful phoenix activity and about complaint mechanisms so that fuller intelligence can be obtained from the public. Ideally a common format for regulator webpages containing consistent information and complaint mechanisms should be adopted, so that the person receives the same information regardless of where they begin their search. This would be a useful outcome of the Interagency Phoenix Forum ('IAPF'), hosted by the ATO.[102] As an extra benefit, well-prepared regulator websites can play an educative role for both potential phoenix victims and for those who might be tempted to engage in harmful phoenix activity.

The regulators referred to throughout this document – ASIC, ATO, FWO – have a range of approaches to receiving reports of misconduct. In May 2016, the Fair Work Ombudsman, Natalie James, announced that an 'Anonymous Report' function had been added to the FWO website.[103] The site allows those who suspect misconduct such as the exploitation of workers to alert the FWO via an online form. At the date of writing, the site does not list 'phoenix activity' as one of the issues that can be reported. The FWO should do so, and include a message that the person making the report should address their complaint to ASIC. The Anonymous Report does do this with unfair dismissal (with a referral to the Fair Work Commission) and with taxation and superannuation (with a referral to the ATO).

[102] The Inter-agency Phoenix Forum ('IAPF') members are listed at ATO, *Membership* <https://www.ato.gov.au/general/the-fight-against-tax-crime/in-detail/inter-agency-phoenix-forum/inter-agency-phoenix-forum/?page=3#Membership>. At the time of writing, other members were still to be added to the list shown on the website. They are the Australian Border Force, Australian Business Register, Department of Human Services and Safe Work Australia.

[103] See FWO, 'Help Us Keep Workplaces Fair' (Media Release, 27 May 2016).

The ATO has a direct phoenix complaint mechanism[104] – an email to phoenix@ato.gov.au but ASIC does not. In response to an emailed request to ASIC 'How do I complain about phoenix activity?', we were directed to ASIC's 'How to Complain' site[105] and 'illegal phoenix activity' site.[106] On this latter site, which contains Information Sheet 212, issued in March 2016, it states the following:

> If you are an employee of a company and the company owes you entitlements (outstanding wages and superannuation)
>
> Contact the Fair Work Ombudsman or call 13 13 94.
>
> Contact the Australian Taxation Office or call 13 28 61.
>
> If the company is in liquidation you should report your concerns to the liquidator …
>
> If you are an employee of a company and you have evidence that the company cannot pay its debts or has transferred assets to another, related company
>
> Report your concerns to ASIC. Information on how to report your concerns is available on the ASIC website.

We tried this. This ASIC website link is the general 'How to Complain' link, noted above. In relation to the ASIC website,[107] the pro-active advice to those who might consider doing business with a possible phoenix operator is unhelpful. It recommends asking the company a series of questions then verifying that information using ASIC Business Checks, an app available for use on smartphones and tablets. The app states:

> The information in this App provides some general steps that you can take to reduce the risks of being swindled by unreliable operators and fly-by-night businesses. While the information provides general guidance, you should be mindful that it cannot protect you in all your business interactions.
>
> As a consumer or small business owner, you need to ensure that your interests are protected when you deal with other businesses. There are five steps that may help you do this:
>
> 1. Ask questions about the company, business and people that you are dealing with [e.g. do you know the company name and Australian Company Number (ACN); the business name and Australian Business Number (ABN)]?

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104 We note the ATO's revamped illegal phoenix activity webpage, released 30 January 2017, which provides valuable information about what the ATO has to offer and what other regulators may do to assist.

105 ASIC, *Contact Us – How to Complain* <http://asic.gov.au/about-asic/contact-us/how-to-complain>.

106 ASIC, *Illegal Phoenix Activity* <http://asic.gov.au/about-asic/contact-us/how-to-complain/illegal-phoenix-activity/>.

107 Note that the Senate Committee inquiry into the performance of ASIC in 2014 recommended a number of improvements to the ASIC website: *SERC Performance of ASIC Report*, above n 92, recommendation 40, [22.38]. The government agreed with this recommendation: Australian Government, above n 93, 20. ASIC has made some general improvements to its website in response to this recommendation. However, as we discuss at [1.3.1], there is still significant scope to improve the ASIC website information and complaint mechanisms relating to phoenix activity.

2. Verify information about the company, business and people you are dealing with by checking ASIC's registers.
3. Seek help from ASIC if you need more information or from a professional business adviser (e.g. an accountant or a lawyer) if you are still unsure about the company, business or people you are dealing with.
4. Monitor the documents lodged by companies by signing up to ASIC's free Company Alert service.
5. Report suspected misconduct to ASIC if you believe that the directors or the company may be acting unlawfully. You can contact us on 1300 300 630 or lodge a complaint online.

We take issue with a number of these points. Public searches of ACNs and ABNs say nothing about a company's financial viability or the people behind the company, and provide no reassurance against 'unreliable operators and fly-by-night businesses'. Checking ASIC registers only reveals information that has been supplied to ASIC by the directors and officers of this company; it does not 'verify' anything about the company or its business, nor does it say anything about the past corporate history of its directors. An attempt by us to 'seek help from ASIC' – ASIC's number three point above – about a specific company led to a recommendation to purchase various documents available from the ASIC registry, and no other help was offered. The Company Alert service lets you know when a document has been lodged, which may be too late to avoid becoming embroiled in a phoenix situation.

It is pleasing to see ASIC invite business people to make a complaint about phoenix activity but elsewhere on the 'illegal phoenix activity' webpage,[108] it cautions:

> We rely on liquidators to provide us with reports about illegal (e.g. fraudulent) phoenix activity. Therefore, if you are concerned about such conduct, the best course of action is to contact the liquidator where one has been appointed …
>
> Generally, we do not act on behalf of individuals to help them recover lost money, including money lost through illegal phoenix activity. You should seek advice about your own remedies.

ASIC needs to present a consistent and correct message, or else it risks 'over-promising and under-delivering'. Given ASIC's role as the corporate regulator, it should provide a straight-forward mechanism for those making the complaints about companies and their directors.

[108] ASIC, above n 106.

Recommendation 6: Improve the advice and complaint functions on regulator websites

- To improve the detection of phoenix activity, there should be a clear and consistent message across regulator websites about what phoenix activity is, how to report suspected phoenix activity, what avenues of redress are available to victims, and how to obtain further advice.
- As a task of the Interagency Phoenix Forum, regulators should endeavour to devise a common format for their phoenix information and complaint webpages.
- The FWO should add phoenix activity as an issue that can be reported on its Anonymous Report webpage.
- Complaint mechanisms should be straightforward, such as the ATO's direct phoenix email address.
- ASIC should revise its phoenix information and complaint webpages to ensure that they are accurate and user-friendly.

1.3.2 Sharing of information between regulators

There needs to be fuller sharing of information amongst regulators. This applies both to suspicions of offences being committed and to raw data that allows regulators to detect instances of harmful phoenix activity. The United Kingdom government, in passing the *Small Business, Enterprise and Employment Act 2015* (UK) claims it will facilitate better 'working between regulators by removing legislative barriers which restrict the use which may be made of information and reports provided by other regulators in deciding whether or not to bring disqualification proceedings' and 'joining-up and more efficient working between financial regulators resulting in more effective interventions'.[109]

In Australia, the general public may have a 'Big Brother' view of government in terms of the sharing of information, but the contrary is true in the context of harmful phoenix activity. Some limits on information sharing are attributable to legislative restrictions stemming from specific Acts as well as general privacy laws[110] but the fact remains that information is not shared amongst regulators as fully and effectively as the law currently allows. Experienced phoenix operators and their advisors are likely to realise that if their wrongdoing is relatively small scale and unobtrusive, it will probably go undetected.

[109] UK Department for Business, Innovation & Skills, *Small Business, Enterprise and Employment Act: Directors' Disqualification and Creditor Compensation Fact Sheet* (2015) 2–3 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/417337/bis-15-264-SBEE-Act-directors-disqualifications-fact-sheet.pdf>.

[110] Privacy is discussed further at [1.4.1].

Improvements must be made to the sharing of raw data amongst regulators. At present, the ATO and the FWO refer suspected phoenix operators to ASIC for action, which may not happen due to ASIC's resourcing and enforcement priorities. These organisations should receive more and better information from ASIC so that they can do their own detection work and utilise their own regulatory tools.

For example, at present, if the FWO receives a report that an employer has been underpaying its workers, it can conduct an ASIC search to discover the name of its directors so that it can bring an accessory action against them.[111] But it cannot discover that the directors have done a similar thing with the previous 15 liquidated entities that they controlled because it cannot search for their names on anything other than the listing of disqualified directors. Accessing prior corporate histories would allow the FWO to decide how strongly to pursue the case and whether, for example, it should proceed to court or accept a settlement. In turn, the FWO could use information about phoenix activity in a referral to ASIC that the directors may have breached their duties as a director by deliberately liquidating companies to avoid large fines against them.[112]

Generally speaking, it is permissible in Australia for government agencies to share information with other agencies. The widest powers are under the *Fair Work Act* where

> The Fair Work Ombudsman may disclose, or authorise the disclosure of, the information if the Fair Work Ombudsman reasonably believes:
>
> (a) that it is necessary or appropriate to do so in the course of performing functions, or exercising powers, under this Act; or
>
> (b) that the disclosure is likely to assist in the administration or enforcement of a law of the Commonwealth, a State or a Territory.[113]

ASIC's power of disclosure is more cautiously expressed. Section 127(1)(a) of the *Australian Securities and Investments Commission Act 2001* (Cth) deals with information 'given to it in confidence in or in connection with the performance of its functions or the exercise of its powers under the corporations legislation.' The section provides that 'the disclosure of information as required or permitted by a law of the Commonwealth or a prescribed law of a State or internal Territory is taken to be authorised use and disclosure of the information.'[114] In addition, s 127(4) provides that

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111 See [3.4.4] for discussion of the orders that can be made against accessories under the *Fair Work Act*.

112 Harmful phoenix activity goes beyond the non-payment of debts such as taxation obligations and employee entitlements. It can be done to avoid a fine or contractual obligation: see, eg, Nick Toscano, 'Supermarket Recycling Business Liquidated to Escape $800,000 Worker Death Fine', *The Sydney Morning Herald* (Sydney), 23 July 2016.

113 *Fair Work Act 2009* (Cth) s 718(2) ('*Fair Work Act*'). The sources of the information are also widely defined: s 718(1).

114 *Australian Securities and Investments Commission Act 2001* (Cth) s 127(2) ('*ASIC Act*').

> [w]here the Chairperson is satisfied that particular information … (b) will enable or assist the government, or an agency, of a State or Territory to perform a function or exercise a power; … the disclosure of the information to the agency, government, officer or body by a person whom the Chairperson authorises for the purpose is taken to be authorised use and disclosure of the information.[115]

In February 2017, the Treasury Laws Amendment (2017 Measures No 1) Bill 2017 was introduced to the House of Representatives. One of its provisions[116] amended the *Australian Securities and Investments Commission Act 2001* (Cth) to allow ASIC to more readily share confidential information with the Commissioner of Taxation.[117] We supported this amendment when the Bill was released for public comment.[118]

The ATO's powers of disclosure are outlined in the *Taxation Administration Act 1953* (Cth), where it may disclose information to a variety of other agencies including ASIC in specified circumstances.[119] When these powers were inserted in 2010, the preceding explanatory memorandum expressly acknowledged that '[i]nformation held by the ATO may be invaluable for ASIC in pursuing action against directors who may repeatedly be engaged in fraudulent phoenix activity.'[120] It appears that secondary disclosure – passing on received information to a third agency – is permissible under some legislation with sufficiently senior sign-off.[121]

Nonetheless, we understand from our discussions with many of those involved in phoenix enforcement that information – confidential or otherwise – does not flow amongst agencies as freely as it might. This issue was raised by the Cole Royal Commission in 2003.[122] It is possible that government agencies adopt a risk-averse approach to sharing information to

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115 Ibid s 127(4)(b).

116 Treasury Laws Amendment (2017 Measures No 1) Bill 2017 (Cth) sch 2 s 1.

117 The amendment adds '(g) the Commissioner of Taxation' to s 127(2A) of the *ASIC Act*.

118 Helen Anderson, Ian Ramsay and Michelle Welsh, Submission to Treasury (Cth), *ASIC-ATO Information Sharing: Exposure Draft*, December 2016.

119 *Taxation Administration Act 1953* (Cth) sch 1, s 355-65 ('*Taxation Administration Act*'). According to the Explanatory Memorandum to the Tax Laws Amendment (Confidentiality of Taxpayer Information) Bill 2010 (Cth), the aim of the Bill was to consolidate and standardise privacy provisions that had previously been spread over many pieces of legislation. While '[t]he key principle of the new framework is the protection of taxpayer information … [d]isclosures of information are, however, permitted in instances where privacy concerns are outweighed by the public benefit of those disclosures': at 3.

120 Explanatory Memorandum, Tax Laws Amendment (Confidentiality of Taxpayer Information) Bill 2010 (Cth) [5.55].

121 See, eg, *Taxation Administration Act 1997* (Vic) s 94, which allows further disclosure of information obtained from a tax officer where it is for the purpose of the enforcement of a law or protecting the public revenue and the Commissioner consents to the disclosure. Primary disclosure is permitted under s 92(1) of that Act where it is made to an 'authorised recipient' listed in s 92(1)(e). Section 92(1)(e) lists several government agencies, including the Victorian Legal Services Board and the Victorian Legal Services Commissioner: ss 92(1)(e)(vii)–(viii).

122 *Cole Royal Commission Report*, above n 23, recommendation 105.

avoid possible breaches of confidentiality rules.[123] Many agencies with an interest in phoenix activity are members of the IAPF. According to the ATO, the IAPF:

> is a key component of the Australian Government's commitment to addressing fraudulent phoenix activity. The forum was established to bring together government agencies to share intelligence, and identify, design and implement cross-agency strategies to reduce and deter phoenix activity.[124]

The Phoenix Taskforce is now a prescribed taskforce,[125] although the membership of the IAPF and the Phoenix Taskforce differ slightly.[126] Taskforce status allows the exchange of tax information within the forum.[127] However, according to the ATO, taskforce status does not permit tax information to be passed on by recipient agencies to others within the forum, or for the ATO to receive information from other agencies.[128] This apparent lack of co-operation led the 2015 SERC Construction Insolvency Report to make a formal recommendation that 'consideration be given to amending confidentiality requirements in statutory frameworks of agencies participating in the Phoenix Taskforce to permit dissemination of relevant information to the ATO.'[129] The Coalition Senators' Additional Comments at the end of that report also noted that:

> As these agencies are characterised by a diversity of aims, powers and responsibilities, any changes to the operation of the Taskforce, including the changes to confidentiality requirements outlined in Recommendation 12, would need to be considered by all the relevant agencies and would take time to resolve.[130]

It is possible that Treasury's Bill in late 2016 to allow ASIC to release confidential information to the ATO without the Chairperson's authorisation is in response to the SERC

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123 See Australian Law Reform Commission ('ALRC'), *Secrecy Laws and Open Government in Australia*, Report No 112 (2009) [15.54]: '…agency culture can prevent information from being disclosed in situations where disclosure would be lawful and appropriate.' The ALRC went on to quote a 2008 Independent Review Panel examining the *Freedom of Information Act 1992* (Qld): 'Inherent at an organisational level, the urgency of the everyday imperatives in modern government can pull the public sector's information culture towards information protection in the interests of issues management, at the expense of the important but less urgent information goals for transparency in government.'

124 ATO, *Fraudulent Phoenix Activities* <https://www.ato.gov.au/general/the-fight-against-tax-crime/our-focus/fraudulent-phoenix-activities/>.

125 *Taxation Administration Act* sch 1 s 355-70(12): 'The regulations [*Taxation Administration Regulations 1976* (Cth)] may prescribe a taskforce for the purposes of item 4 of the table in subsection (1). A major purpose of the taskforce must be protecting the public finances of Australia.' Regulation 48 of *the Taxation Administration Regulations 1976* (Cth) contains a current list of prescribed taskforces, including the 'Phoenix Taskforce'.

126 See ATO, above n 124.

127 *Taxation Administration Act* sch 1 s 355-70(1) item 4, inserted by the *Tax Laws Amendment (Confidentiality of Taxpayer Information) Act 2010* (Cth) sch 1 item 1. The ATO makes the information available to the Taskforce, and member agencies can access that information from the Taskforce. The information can only be used for prescribed taskforce purposes.

128 *SERC Construction Insolvency Report*, above n 14, [5.64].

129 Ibid, recommendation 12, [5.84].

130 Ibid 197.

recommendation.[131] It would be highly beneficial to the detection of harmful phoenix activity if this sort of legislative amendment could be made more widely.

The Phoenix Watchlist, managed by the Registrar of the Australian Business Register ('ABR'), was established, following an allocation in the May 2013 federal budget, as 'a register of known or suspected phoenix operators'.[132] There was little publicly available information about the watchlist and it appeared to be receiving information only from the ATO.[133] We understand that the phoenix watchlist has not proved to be successful and was to be replaced in 2015 with a 'serial insolvency alert'.[134] However, we have no details about this program or whether it has been implemented.

The ABR could be a useful platform for information sharing between government agencies. The ABR has two portals – ABN Lookup, which is available to the public, and ABR Explorer, which is available to authorised government agencies.[135] The latter is relevant to the present discussion. At present, it allows specified agencies, upon agreeing to various privacy constraints, to access ABR non-public data. This includes the names and addresses of representatives and associates of ABN holders. But even this information is of limited utility because it does not extend to the prior corporate history of those people. This is the crux of harmful phoenix activity – either it is done repeatedly by someone who lacks the ability to make each business a success, or it is done deliberately to shed corporate debts. Prior corporate history is vital information.

If the recommendations about a DIN and improvements to EXAD reporting were adopted,[136] ASIC would be in possession of large amounts of highly valuable information. ASIC should

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131 Another possible reason for the proposed amendment is recommendation 15 of the *SERC Corporate Tax Avoidance Report*, above n 51, which calls for s 127 of the *ASIC Act* to 'be amended to allow ASIC to share information with the ATO without having to notify the affected person': at [6.74].

132 *SERC Construction Insolvency Report*, above n 14, [5.69]. A phoenix watchlist was first recommended in Australian Securities Commission, 'Project One: Phoenix Activities and Insolvent Trading – Public Version' (Research Paper 95/01, 13 May 1996) recommendation 16, 81–2.

133 In its April 2015 submission to the SERC Construction Insolvency inquiry, the ATO noted that it had 'provided information regarding 154 confirmed Phoenix operator groups with 2,184 linked entities through the Phoenix Watchlist' and that it was working to provide further data in the future: ATO, Submission No 5 to Senate Economics References Committee, *Inquiry into Insolvency in the Australian Construction Industry*, 17 April 2015, [79]. No other submissions by regulators indicated that any intelligence had been provided to the Watchlist, nor have we been able to identify any other publicly available information to that effect.

134 See ATO, *ABR Advisory Board Minutes – May 2015* <https://www.ato.gov.au/General/Consultation/In-detail/Stakeholder-relationship-and-management-groups---minutes/ABR-Advisory-Board/ABR-Advisory-Board-minutes---May-2015/>.

135 Australian Business Register, *ABR Explorer* <https://abr.gov.au/For-Government-agencies/Accessing-ABR-data/ABR-Explorer/>.

136 This would necessitate privacy safeguards and protection for the external administrators against defamation. External administrators enjoy qualified privilege in providing reports of misconduct to ASIC. This protects them from actions for defamation in the absence of malice: *Corporations Act* ss 89, 426, 442E, 535. This is also noted in *ASIC Regulatory Guide 16*, above n 89, [16.59].

be allowed to contribute that information to the ABR Explorer, and that information should then be available to other permitted agencies who can take protective or enforcement action. For example, the ATO could implement pro-active measures, such as surveillance or asking for a security bond where it is highly likely that taxes will remain unpaid.[137] The Department of Employment would benefit in knowing whether they should fund a liquidator to recover from errant directors the Fair Entitlements Guarantee ('FEG') payments made to their companies.[138]

ASIC currently provides the ABR with information about companies entering external administration or being deregistered for a variety of reasons, including failure to pay fees.[139] This prompts the ABR to cancel the company's ABN. One innovation that would not require any new legislation would be for the ABR, if it discovered that the people associated with a cancelled ABN were seeking a new ABN, to alert ASIC and other agencies to this activity under the rubric of the ABR Explorer. This would not involve an implication of wrongdoing but simply adds to the useful intelligence held by ASIC that can guide their surveillance and enforcement activities.

It may also indicate to ASIC that prior companies have been abandoned. This generally involves failure to return documents to ASIC or pay fees. We highlight the issue of abandoned companies here because:

- they may be the locus of wrongdoing that needs the proper attention of a regulator or external administrator;
- abandoned companies may have victims who lack access to the usual means of redress;
- the legislative reforms of 2012, as discussed below, have proven to be inadequate to tackle the problem;
- these companies may continue to operate to the detriment of many.

Some solvent companies may be abandoned after paying out all their debts and not be liquidated, for example by those who are entering retirement. This could be because of ignorance or to avoid the cost of the winding up process. However, we believe that abandoned companies can also facilitate harmful phoenix activity that is likely to go undetected because they are not the subject of much regulatory scrutiny.

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137 The difficulties with obtaining bonds is discussed further at [2.3] and a suggestion is made to overcome these difficulties.

138 See Department of Employment (Cth), *FEG Recovery Program* <https://www.employment.gov.au/feg-recovery-programme>; below nn 369–370 and accompanying text.

139 See *Corporations Act* s 601AB.

In 2014-15, 7,044[140] companies entered liquidation. This represented only 6.2% of the 112,714[141] companies that were deregistered in that year.[142] ASIC has informed us[143] that of the remaining companies, 42,059 were deregistered at ASIC's instigation under s 601AB of the *Corporations Act*. Of these, about 89.4%,[144] or 37,600 companies, are believed to have been wound up pursuant to s 601AB(1) for failure to respond to a return of particulars, lodge documents and carry on a business or pursuant to s 601AB(1A) for failure to pay fees. In 2015-2016, there were a total of 123,050 deregistered companies,[145] but we do not have the abandoned company figure for that year.

Since 2012, ASIC has had the power to wind up abandoned companies so that their employees can access the FEG[146] but in 2014–15 ASIC used its powers to appoint liquidators to just 31 companies.[147]

A problem with abandoned companies is that they are not subject to the scrutiny of a liquidator. Because there may be unpaid taxes and unpaid employee entitlements by these abandoned companies, ASIC should ensure that information about the companies *and* their directors is shared with other regulators prior to the company being deregistered.

Under s 601AB(3) of the *Corporations Act*, if ASIC decides to deregister a company it must not only give notice of the proposed deregistration to the company and its directors, it must also publish notice of the proposed deregistration at least two months before it occurs. When publishing notice of the deregistration ASIC provides the name of the company and its ACN.[148] However, the notice does not contain the details of the company's directors. Information about the directors of a company can be important in the context of harmful phoenix activity where individuals may be a director of more than one company.

Accordingly, in addition to publishing the notice required under s 601AB(3), ASIC should notify other members of the Phoenix Taskforce of the names of a company's directors prior

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140 See ASIC, *Australian Insolvency Statistics: Series 1 – Companies Entering External Administration, January 1999–November 2016*, Table 1.3 <http://download.asic.gov.au/media/4127067/asic-insolvency-statistics-series-1-published-january-2017.pdf>. This figure has been calculated by aggregating the annual figures for '[c]ourt wind-up' and '[c]reditors wind-up' in 2014–15.

141 ASIC, *Annual Report 2014–2015* (15 October 2015) 66.

142 Note that the year of liquidation and the year of deregistration may not correspond exactly. However, these statistics give a sense of the scale of liquidations compared to deregistrations.

143 Email from Adrian Brown of ASIC to Helen Anderson, 18 March 2016.

144 Ibid.

145 ASIC, above n 11, 86.

146 *Corporations Act* s 489EA, inserted by *Corporations Amendment (Phoenixing and Other Measures) Act 2012* (Cth) sch 1 item 1.

147 ASIC, 'ASIC Winds Up 12 Abandoned Companies that Owed More than $335,000 in Employee Entitlements' (Media Release, 15-164MR, 30 June 2015).

148 See ASIC, *Insolvency Notices* <http://asic.gov.au/regulatory-resources/insolvency/insolvency-notices/>.

to ASIC deregistering the company. This allows these other members of the Taskforce to check their own databases to ascertain if there are any matters of concern, for example, outstanding debts, that would mean that deregistration should not proceed.

The risk that insufficient oversight of the deregistration process may be facilitating harmful phoenix activity was identified more than 20 years ago in the ASC's 1995 research paper into phoenix activities and insolvent trading:

> Importantly it would appear that approximately 92% of Phoenix companies are deregistered under the ASC's section 574 program [the predecessor to s 601AB of the *Corporations Act*].
>
> 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.
>
> A review of the objectives and goals of the s 574 program should be undertaken … Some of the areas covered in this review of the s 574 program could include:
>
> - should the ASC require a certificate from all directors before deregistering a company that no creditor has been left unpaid?
> - what impact would this have upon the important database cleaning functions of the s 574 program?
>
> While it was not within the scope of this research to examine the operation of the s 574 program we provide recommendations as follows:
>
> Recommendation 13: That a detailed examination of the s 574 program's objective and outcomes be undertaken with a view to addressing Phoenix activity.[149]

Despite this problem having been identified in 1995, there is still a significant risk that deregistration of Oldcos may be effectively 'writing off' debts to creditors and employees on a large scale, as a result of the lack of scrutiny of abandoned companies.

The recent matter of Leigh Alan Jorgensen[150] provides a good example of the importance of regulators sharing information about the deregistration of companies. On 19 June 2015, the Federal Circuit Court ordered that a company of which Mr Jorgensen was the sole director

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149 Australian Securities Commission, above n 132, 75.

150 ASIC, 'Former Company Director Charged with Making False or Misleading Statements' (Media Release, 17-023MR, 6 February 2017).

and shareholder, ACN 156 455 828 Pty Ltd (trading as 'Trek North Tours'), pay a pecuniary penalty in the sum of $55,000 to the Commonwealth for failure to pay employee entitlements under the *Fair Work Act*.[151] ASIC alleges that in February 2016 Mr Jorgensen lodged a Form 6010 with ASIC to voluntarily deregister ACN 156 455 828 Pty Ltd in which he allegedly falsely and misleadingly claimed the company had no outstanding liabilities. Mr Jorgensen has been charged with contravening s 1308(2) of the *Corporations Act* and is due to appear in the Cairns Magistrates Court on 21 March 2017. ASIC was able to take action against Mr Jorgensen because of a tip-off from the FWO about the outstanding penalty ordered against ACN 156 455 828 Pty Ltd.[152] This should happen as a matter of course. ASIC should notify other regulators of directors applying for deregistration and other regulators should check their databases for any outstanding liabilities. If there are outstanding liabilities, the matter should be referred immediately to the appropriate regulator for enforcement action.

It is time to review the wider dissemination of the data that might identify harmful phoenix activity. A review should reveal whether new law is needed or simply more and better attempts by regulatory agencies to use the information exchange powers that they already have. The Draft Report of the Productivity Commission's inquiry into data availability and its use does not appear to contain anything relevant to the detection of harmful phoenix activity.[153]

Recommendation 7: Increase information sharing between regulators

- The recommendation of the 2015 SERC Construction Insolvency Report that 'consideration be given to amending confidentiality requirements in statutory frameworks of agencies participating in the Phoenix Taskforce to permit dissemination of relevant information to the ATO' should be implemented, and these amendments should be extended so that information can be given to other agencies via the Australian Business Register.
- The disclosure laws under the *Fair Work Act* should be considered as a possible template for information disclosure generally.
- The ABR should be directed to alert ASIC and other agencies, via the ABR Explorer, if it discovers that the people associated with a cancelled ABN are seeking a new ABN.

151 *Fair Work Ombudsman v Trek North Tours (No 2)* [2015] FCCA 1801. The Federal Circuit Court also ordered, *inter alia*, that Jorgensen pay a pecuniary penalty in the sum of $12,000 to the Commonwealth on the basis that he was involved in the company's contraventions pursuant to s 550(1) of the *Fair Work Act*. See [3.4.4] for further discussion of the orders that can be made against accessories under the *Fair Work Act*.

152 ASIC, above n 150.

153 Productivity Commission, *Data Availability and Use: Draft Report* (2016). Its terms of reference are broad enough to encompass the matters raised in Chapter 1 of this report: at v–vii.

- Prior to deregistering a company, ASIC should notify other members of the Phoenix Taskforce of the name and ACN of the company *and* the names and DINs of its directors. Upon notification, the other members of the Phoenix Taskforce should search their databases to check whether the company or its directors have outstanding liabilities and, if so, refer the matter for enforcement action.

1.4 Assist creditors and employees to detect harmful phoenix activity

Information about companies and directors should be readily available to the public so that creditors and employees can vet companies and their managers to protect themselves against harmful phoenix activity. We recommend making detailed information about companies available to the public free-of-charge and establishing a searchable register (see [1.4.2]) of disqualified and 'restricted' directors. Director restriction is a new protective mechanism that we recommend introducing in relation to directors who have been involved in five or more corporate failures within the previous ten years (see [2.1] for further discussion). We believe these proposals would play a significant role in reducing the incidence of harmful phoenix activity.

1.4.1 Public availability of data

An ounce of prevention is worth a pound of cure, so the saying goes. Potential victims of harmful phoenix activity can avoid being hurt by equipping themselves with information. This has the capacity to reduce the demand for later enforcement action by regulators. The abuse of the corporate form through phoenix activity is able to exist partly because of its ability to masquerade as a legitimate business rescue. The more information that is in the hands of creditors and employees before the event, the more likely it is that harmful phoenix activity will lose its appeal.[154]

Currently, harmful phoenix activity is simply too easy and too profitable for many offenders to resist, since it is unlikely that anyone will 'join the dots'. Creditors have little chance of detecting directors' history of repeated phoenix activity from publicly available records about the company they are presently dealing with. There is limited information available without charge on ASIC's databases. Even if company documents are bought, a search of its documents does not reveal the past corporate history of its directors or other company officers.

[154] For example, the SERC noted that 'information is critical in inhibiting illegal phoenix activity and in preventing small-scale insolvencies turning into larger collapses': *SERC Construction Insolvency Report*, above n 14, [12.15].

We are not the only ones calling for ASIC information to be widely available. The Senate Economics References Committee looking at ASIC's performance in 2014 recommended that ASIC 'promote "informed participation" in the market by making information more accessible and presented in an informative way.'[155] The lack of easily locatable information about directors' prior corporate history cannot be justified as 'red-tape reduction'. The information is already there. It simply needs to be collated from existing document lodgements and made available by ASIC. Nor is the information confidential. It is already in the public domain, and with enough searching and paying for documents, a creditor would be able to locate it. Indeed, credit reporting agencies can piece the information together if creditors are prepared to pay for it, and larger suppliers commonly use their services for this purpose.

The parties who lack access to information but for whom information is crucial for self-protection are independent contractors and other small unsecured trade creditors for whom paid credit searching may not be economical. Because these parties are unable to enforce their debts directly once the company enters liquidation,[156] any recovery they receive is at the lowest rank of unsecured creditor. This typically is less than 11 cents in the dollar.[157] These parties need information *before* any contract is entered into[158] so that a decision can be made whether to do business with this company at all and if so, what price to charge. Once again, this lack of information was highlighted by the 2015 SERC Construction Insolvency Report, and their first recommendation was that

> ASIC conduct a review of administrators' and liquidators' reporting requirements and the range and extent of information it requires to be reported and, where necessary, make changes that will ensure the regulator is able to fully inform itself, the Parliament and the public with complete, relevant and up-to-date data on insolvencies.[159]

This was followed up with recommendations about 'early warning to industry participants about repeat and concerning insolvent practices'[160] and 'that regulators increase engagement

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155 *SERC Performance of ASIC Report*, above n 92, recommendation 39, [22.28].

156 *Corporations Act* s 471B.

157 ASIC, *Report 507: Insolvency Statistics – External Administrators' Reports (July 2015 to June 2016)* (December 2016) ('*ASIC Report 507*'): '[i]n 97% of cases, the dividend estimate was less than 11 cents in the dollar': at 7. This was also the case in 2014–15 and 2013–14.

158 ASIC does allow interested parties to register under their Company Alert system, which sends a message when a specified company lodges various documents, including those relating to changes of director and external administration: see ASIC, *Alerts* <http://asic.gov.au/online-services/alerts/>. However, the person seeking the information must still pay to obtain the document. In addition, the alert expires annually unless renewed.

159 *SERC Construction Insolvency Report*, above n 14, recommendation 1, [2.62].

160 Ibid recommendation 4, [2.65].

efforts with industry participants aimed at increasing and enhancing information flows.'[161] Of particular importance is their recommendation 'that ASIC and Australian Financial Security Authority company records be available online *without payment of a fee*.'[162]

The Australian Government has abandoned its plans to privatise the ASIC registry. However, it is important not to equate the decision to abandon the privatisation of the ASIC registry with a decision to make ASIC information free-of-charge. Indeed, the fact that the decision to abandon privatisation was made on financial grounds[163] raises a question about whether the government would be willing to forego the significant revenue generated from ASIC registry fees.[164] ASIC and the government need to take the next step of providing free-of-charge access to information in the ASIC registry, for the reasons set out below.

First, providing free-of-charge access to ASIC registry information appears to be required by the government's policy for 'Better and More Accessible Digital Services',[165] including its Public Data Policy.[166] The government's *Public Data Policy Statement* provides that Australian Government entities will 'where possible, make data available with free, easy to use, high quality and reliable Application Programming Interfaces' and 'only charge for specialised data services and, where possible, publish the resulting data open by default.'[167] As CPA Australia CEO Alex Malley observed, privatisation of the ASIC registry 'has always been in conflict with the government's own open data policy which commits to release non-sensitive data as open by default.'[168]

Second, making corporate registry information available free-of-charge is consistent with the approach being taken to this issue overseas. Mr Malley remarked in response to the government's decision to abandon its plans to privatise the ASIC Registry, '[t]he challenge ahead is that registry information that is free in other comparable jurisdictions like the USA, UK and New Zealand is expensive and difficult to access here. That's something that needs to be addressed.'[169] Increased transparency in Australia would follow the trend set in

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161 Ibid recommendation 14, [5.86].

162 Ibid recommendation 39, [12.41] (emphasis added).

163 See Lucy Battersby, 'Government Abandons Plans to Outsource ASIC Registry', *The Sydney Morning Herald* (Sydney), 19 December 2016.

164 ASIC, above n 11, 26: '[i]n 2015–16, ASIC raised $876 million for the Commonwealth in fees and charges, an increase of 6.4% from 2014–15. The increase in revenue is driven by continued net company growth coupled with fee indexation.'

165 The Liberal Party of Australia, *The Coalition's Policy for Better and More Accessible Digital Services* (June 2016).

166 Department of the Prime Minister and Cabinet (Cth), *Public Data Policy* <https://www.dpmc.gov.au/public-data/public-data-policy>.

167 Australian Government, *Australian Government Public Data Policy Statement* (7 December 2015).

168 Battersby, above n 163.

169 Ibid.

European Union countries[170] and the UK.[171] According to UK Secretary of State for Business, Innovation and Skills, the Rt Hon Dr Vince Cable,

> [t]he government firmly believes that the best way to maximise the value to the UK economy of the information which Companies House holds, is for it to be available as open data. By making its data freely available and free of charge, Companies House is making the UK a more transparent, efficient and effective place to do business.[172]

UK Companies House still charges small fees to access certain more detailed documents about companies, such as £1 for a 'company record' or 'mortgage statement'.[173] However, a large amount of basic information is now free-of-charge via a user friendly-search engine,[174] including: an overview of the company and its status; its filing history with hyperlinks to the corresponding PDF documents; a list of active and resigned officeholders; and insolvency information, among other details. It is possible to search for either a company or an officer and then click into the company or officer to determine which officers are associated with which companies and vice versa. Importantly, the register indicates whether officers are disqualified and provides basic details of the disqualification. As discussed further at [1.4.2], detailed information about disqualifications, including a summary of the misconduct that gave rise to the disqualification, is made available by the UK Insolvency Service for three months following the disqualification.[175]

France has recently announced the introduction of an online, publicly accessible, register of trusts containing information about the trust and its trustees, settlors and beneficiaries.[176] Providing transparency about trusts is intended to end 'use of shell companies for tax evasion, money laundering and financing illicit activities.'[177]

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170 See European Union, *Insolvency Registers* <https://e-justice.europa.eu/content_insolvency_registers-110-en.do>: 'The information and documents you can find in these registers [national insolvency registers] should be *available for free*.'

171 See UK Companies House, 'Launch of the New Companies House Public Beta Service' (News Story, 22 June 2015): '[i]n line with the government's commitment to free data, Companies House is pleased to announce that all public digital data held on the UK register of companies is now accessible free of charge, on its new public beta search service. This provides access to over 170 million digital records on companies and directors including financial accounts, company filings and details on directors and secretaries throughout the life of the company.'

172 UK Department for Business, Innovation & Skills, 'Free Companies House Data to Boost UK Economy' (Press Release, 15 July 2014).

173 For information on UK Companies House's services and fees, see: UK Companies House, *About Our Services* <https://www.gov.uk/government/organisations/companies-house/about/about-our-services>.

174 See UK Companies House, *Search the Register* <https://beta.companieshouse.gov.uk/>.

175 See UK Insolvency Service, *Director Disqualification Outcomes: Summary of Results* <https://www.insolvencydirect.bis.gov.uk/IESdatabase/viewdirectorsummary-new.asp>.

176 Decree No 2016-567 of 10 May 2016 (France) JO, 11 May 2016, 0109.

177 Press release of the Finance and Public Accounts Ministry of 11 May 2016, cited in Kramer Levin Naftalis & Frankel LLP, *Creation in France of a Public Register of Trusts* (20 May 2016).

Third, there is now a mounting body of evidence indicating that open data adds significant value to the economy. Lateral Economics estimates the potential value of open data (including government, research, private and business data) to the Australian economy at up to $64 billion per annum,[178] while PwC estimates that data-driven innovation added an estimated $67 billion in new value to the Australian economy in 2013, leaving another $48 billion in unrealised potential value.[179] PwC concludes that '[g]overnment should prioritise the provision of open data as a key input for the Australian economy and provide senior political leadership to "get on with it" in order to support wider innovation by other players.'[180] The World Bank notes that '[w]hile sources differ in their precise estimates of the economic potential of Open Data, all are agreed that it is potentially very large' and 'governments should consider how to use their Open Data to enhance economic growth, and should put in place strategies to promote and support the use of data in this way.'[181]

A report by the Australian Bureau of Communications Research in February 2016, which estimates the value of Open Government Data to the Australian economy at up to $25 billion per year, concluded that '[w]hile there is little consensus on the magnitude of the economic benefits of open government data sets, it is apparent that they provide substantial current and potential net benefits to the economy and society.'[182] The Bureau consulted with the Securities Industry Research Centre of Asia-Pacific ('SIRCA') in the process of preparing the report, which made the following comment in regard to ASIC's data provision practices:

> SIRCA believes ASIC's current model of data provision is limiting innovation; information is only provided on the title of a document with a pay-per-view model for access. There is a significant information asymmetry here—only the holders of data know what is there, while the users don't have the full picture. With limited information, the opportunities for innovation are not fully understood, and hence the potential business case for opening the data is limited. Fully readable and searchable data would be preferred, noting that similar institutions overseas do provide this service for free to encourage financial system innovation.[183]

While there are many good reasons for providing better access to corporate registry information, confidentiality restrictions may prevent the disclosure of some information.

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178 See Lateral Economics, *Open for Business: How Open Data Can Help Achieve the G20 Growth Target* (June 2014) 32.

179 See PricewaterhouseCoopers, *Deciding with Data: How Data-Driven Innovation is Fuelling Australia's Economic Growth* (September 2014) 1.

180 Ibid.

181 The World Bank, *Open Data for Economic Growth* (25 June 2014) [45].

182 Bureau of Communications Research, Department of Communications and the Arts (Cth), *Open Government Data and Why It Matters Now* (February 2016) 33.

183 Ibid.

ASIC's Regulatory Guide 103 'Confidentiality and Release of Information'[184] outlines the practices it has adopted in relation to disclosure of information based on its reading of the High Court's decision in *Johns v Australian Securities Commission*.[185] However, we note that Regulatory Guide 103 has not been updated for over 20 years. As a preliminary step towards wider availability of free information, we recommend that ASIC review and clarify its ability to disclose information about companies and their directors and update its regulatory guidance accordingly.

Any initiatives to publicise information about company directors must also comply with the provisions of the *Privacy Act 1988* (Cth) which was amended in 2012.[186] The Act only covers the information of individuals, not companies, and as far as the individuals are concerned, identity verification is not covered by the *Privacy Act*.[187] The Australian Privacy Principles, which form part of the Act,[188] do allow an organisation to adopt a government related identifier of an individual as its own identifier if to do so is authorised by an Australian law or a court or tribunal order.[189] Information about prior corporate histories of directors would be covered by the *Privacy Act* and must comply with both Australian Privacy Principles, as well as the credit reporting provisions[190] of the Act where that information is publicly disseminated by credit reporting agencies.

However, exemptions from provisions of the *Privacy Act* can be obtained, and there should be further exploration of what might be possible here in relation to corporate history information.

Recommendation 8: Make information about companies public and free-of-charge

- Australia should follow the lead set in the United Kingdom and some European countries by allowing free searches of lodged company and director information.
- ASIC should review and clarify its ability to disclose information about companies and their directors and update its regulatory guidance accordingly.
- Where necessary, exemptions should be made to the *Privacy Act* to allow easy searching and location of directors' corporate histories.

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184 ASIC, *Regulatory Guide 103: Confidentiality and Release of Information* (issued 27 November 1995, updated 26 February 1996) 2.

185 (1993) 178 CLR 408. This case concerned the disclosure to a Royal Commission of information obtained via a private examination by an ASC officer, which was later revealed in the Royal Commission's publicly available transcripts.

186 *Privacy Amendment (Enhancing Privacy Protection) Act 2012* (Cth).

187 See David Francis, 'Summary of the Impact of the Amendments to the Privacy Act' (2014) 21(5) C*redit Management in Australia* 8, 8.

188 *Privacy Act 1988* (Cth) sch 1.

189 Ibid s 20L(2), sch 1, Australian Privacy Principle 9.

190 Ibid pt IIIA.

1.4.2 Register of disqualified and restricted directors

There should be easy and free public access to information about directors who have been disqualified or 'restricted' (see [2.1] for discussion of the proposed director restriction scheme).

At present, it is difficult for creditors, employees and taxation authorities to check whether company managers are or have been disqualified by ASIC or the courts and on what grounds. If this information were more easily accessible, it would enable these parties to better protect themselves against company managers who have shown a tendency to engage in harmful phoenix activity or other forms of corporate and financial wrongdoing. Here, we recommend establishing a free-of-charge, easily searchable online register that facilitates access to information on disqualified and restricted directors.

Currently, there are two ways to obtain information on whether a person has been disqualified from managing corporations, provided the name of the person is known, rather than just the name of the company or companies with which they are affiliated. One way is to search for the person's name in ASIC's 'Banned & Disqualified' registers on the ASIC Connect website.[191] The other way is to search for the person's name in ASIC's 'Banned and Disqualified Persons Dataset' on data.gov.au.[192] These sources provide information on the duration of the disqualification period and the address of the disqualified person. From the ASIC Connect website, it is also usually possible to purchase a copy of the banning documents, which start at $19 for an uncertified copy or $38.00 for a certified copy.

Typically, the banning documents comprise a single page that states the legislative provision pursuant to which the order was made (e.g. ss 206F, 206C) and the duration of the disqualification period. However, it is not usually possible to access documents indicating the reasons for which the disqualification order was made. For instance, it is not possible to ascertain whether a disqualification order pursuant to s 206F was made partly because of the director's involvement in suspected unlawful activity, or whether it was made only on the basis of involvement in failed companies. This information is sometimes available via ASIC's media releases, although our research indicates that only about 50% of orders made under s 206F are covered in media releases.[193]

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191 ASIC, *Search ASIC Registers* <https://connectonline.asic.gov.au/RegistrySearch/faces/landing/SearchRegisters.jspx?_adf.ctrl-state=15mgsebwpo_4>.

192 Australian Government, data.gov.au, *ASIC Banned and Disqualified Persons Dataset* <https://data.gov.au/dataset/asic-banned-disqualified-per>.

193 We found that 398 of the 801 management disqualification orders made between 1 January 2001 and 31 December 2015 were covered in ASIC's media releases.

If creditors, employees or taxation authorities are seeking to check the people managing a company and they only know the name of the company, rather than the names of the individual managers, the names of the managers can be ascertained by searching for the company name in ASIC's 'Organisation & Business Names Register'[194] and then purchasing a company extract for $9.00 to identify the officeholders of the company. [195] As explained above, the name of each officeholder can then be searched in ASIC's 'Banned & Disqualified' registers or the 'Banned and Disqualified Persons Dataset' on data.gov.au.

The above processes are laborious, time-consuming and expensive. While ASIC's publishing of the 'Banned and Disqualified Persons Dataset' on data.gov.au in 2016 was a step in the right direction, there is significant scope for improvement. The dataset, which is an Excel spreadsheet, is not easy to locate or user-friendly. The spreadsheet is not available on ASIC's website, which instead redirects readers to ASIC's datasets on data.gov.au.[196] Once the document has been located, there are a number of obstacles to interpreting its content, including: a lack of plain language headings; broadly categorised types of bans that are only briefly explained in an accompanying 'Help File';[197] the use of a blank end date to indicate permanent bans, rather than any express label to that effect; and thousands of duplicate entries as a result of bans being entered under different names and addresses.

Limited information, and that being available only at a cost, is at odds with ASIC's stated commitment to transparency and open data.[198] It is also inconsistent with the government's Public Data Policy, which is discussed at [1.4.1] and which provides that fees can only be charged for 'specialised data services'.[199] The government's *Information Sheet on Charging for Data Services* suggests that 'specialised data services' only include data provision services that require tailored processes or infrastructure in order to provide specific types of data.[200] This does not appear to be the case with regard to ASIC's management disqualification orders, which are already uploaded to ASIC's online registers and available to download as soon as the fees are paid.

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194 ASIC, above n 191.

195 ASIC, *Fees and Examples of Paid Products* <https://connectonline.asic.gov.au/OPH/HelpLandingPages/TH_PurchasingSearchItems/SCH_TH_FEES_PAID_PRODUCTS>.

196 See ASIC, *Data.gov.au* <http://asic.gov.au/online-services/search-asics-registers/datagovau/>.

197 See ASIC, *Banned and Disqualified Persons Dataset: Help File* (16 June 2016) <https://data.gov.au/dataset/asic-banned-disqualified-per/resource/ff65011c-12fa-4d1a-817d-2601deaaacae>.

198 ASIC, *Public Comment on ASIC's Regulatory Activities* <http://asic.gov.au/about-asic/asic-investigations-and-enforcement/public-comment-on-asics-regulatory-activities/>; ASIC, above n 196: '[w]e are committed to promoting open data and all the advantages that it brings.'

199 Australian Government, above n 167.

200 See Department of Finance (Cth), *Information Sheet: Charging for Data Services* (24 December 2015).

To give effect to the government's *Public Data Policy Statement* and ASIC's commitment to transparency and open data, free-of-charge access to detailed information on persons disqualified from managing corporations or subject to restricted directorships ought to be made readily available to the public. This should be in the form of an online, free-of-charge register of disqualified and restricted directors that can be browsed and searched using key terms. It should contain hyperlinks to the orders and reasons for the orders where applicable, redacted for confidentiality reasons if necessary, similar to the register that already exists for enforceable undertakings[201] but with the addition of a search engine function. Importantly, the register ought to link the name of the disqualified or restricted individual and the name of corporate entities with which they are and were relevantly affiliated, to enable users to search the register either by individual name or company name. The linking of the individuals with the companies with which they are connected would be facilitated by the recommendations to establish a DIN, at [1.1.1] and to collect more detailed information on directors' corporate histories, at [1.1.2].

In terms of an existing model for an improved register of disqualified and restricted directors, much can be learned from the approach taken to disqualification in the UK, which is helpfully described in the UK Insolvency Service's information sheet, *Unfit Conduct: Our Disqualification and Restrictions Search Facilities.*[202] The UK has two registers, one maintained by the Insolvency Service[203] and one by Companies House,[204] which together provide the following information in regard to disqualifications: name; date of birth; address; company names; company numbers; start and end date; legislative section; and misconduct. The Insolvency Service register provides a more detailed account of the disqualification, including, importantly, a written summary of the conduct that resulted in the disqualification. This detailed summary of the disqualification is accessible for three months, after which it is necessary to refer to the Companies House register, which provides more basic information for the complete duration of the disqualification period. Both registers have relatively user-friendly interfaces and the Gov.UK website provides clear and helpful guidance on how to search the registers.[205] Our view is that it is preferable for detailed information relating to the

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201 ASIC, *Enforceable Undertakings Register* <http://asic.gov.au/online-services/search-asics-registers/additional-searches/enforceable-undertakings-register/>.

202 UK Insolvency Service, *Unfit Conduct: Our Disqualification and Restrictions Search Facilities* (December 2016). While this document refers to both 'disqualification' and 'restrictions' search facilities, the UK does not have 'restricted' directorships as proposed in [2.1] of this report. The 'restrictions' refer instead to bankruptcy and debt relief restrictions, which result in disqualification from management of companies pursuant to s 11 of the *Company Directors Disqualification Act 1986* (UK). This is similar to automatic disqualification on grounds of bankruptcy in Australia: *Corporations Act* ss 206B(3)–(4).

203 UK Insolvency Service, above n 175.

204 UK Companies House, *Register of Disqualifications* <https://beta.companieshouse.gov.uk/register-of-disqualifications/A>.

205 UK Companies House, *Company Director Disqualification* <https://www.gov.uk/company-director-disqualification>; UK Companies House, *Search for Disqualified Company Directors* <https://www.gov.uk/search-the-register-of-disqualified-company-directors>.

disqualification order to remain on the register indefinitely (not only for three months or the duration of the ban) but the UK model is otherwise very informative.

In addition to people who have been disqualified from managing corporations by ASIC or the courts or automatically restricted, the government should consider how people who are automatically disqualified from managing corporations under s 206B of the *Corporations Act* could be included in the proposed online register. For this to be possible, ASIC would need to be aware of the identities of people who are disqualified under s 206B, which would require a high degree of cooperation and information sharing between ASIC and other law enforcement bodies. The reason for this is that s 206B is very broad in its application. It applies to any person who has been convicted of one or more of the following categories of offences within the prescribed time periods:

- If the conviction is on indictment, a domestic or foreign offence that: concerns the making, or participation in making, of decisions that affect the whole or a substantial part of the business of the corporation; or concerns an act that has the capacity to affect significantly the corporation's financial standing.[206]
- An offence that is a contravention of the *Corporations Act* and is punishable by imprisonment for a period greater than 12 months.[207]
- Any domestic or foreign offence that involves dishonesty and is punishable by imprisonment for at least three months.[208]
- Any foreign offence that is punishable by imprisonment for a period greater than 12 months.[209]

There may be many thousands of people in Australia who have been convicted of one of the above categories of offences in a range of different courts, both domestic and foreign. Somehow, ASIC would need to be able to access information about these convictions from the relevant law enforcement bodies. While this is a significant information sharing challenge, it is important that the government consider ways to monitor compliance with s 206B, as it is otherwise an unenforceable legislative provision and likely to be ineffective. Those who have engaged in criminal conduct falling into one of the above categories are arguably at a higher risk of engaging in illegal phoenix activity and other forms of corporate wrongdoing, so it is important that they are not able to manage corporations in contravention of s 206B.

206 *Corporations Act* s 206B(1)(a).
207 Ibid s 206B(1)(b)(i).
208 Ibid s 206B(1)(b)(ii).
209 Ibid s 206B(1)(c).

Recommendation 9: Establish an online register of restricted & disqualified directors

- ASIC should establish registers of directors who are restricted (see Recommendation 14) or disqualified that:
  - are online and available via the ASIC website with a user-friendly interface;
  - are entirely free-of-charge to view and download linked documents;
  - can be both browsed and searched using key terms via a search engine function;
  - contain hyperlinks to the disqualification orders *and* the reasons for the orders (in the case of non-automatic disqualification);
  - provide the name and ACN of all companies of which the disqualified or restricted person is or has been an officer; and
  - subject to feasibility considerations, include people who are automatically disqualified from managing corporations under s 206B of the *Corporations Act*.

1.5 Assist others to detect harmful phoenix activity

There are three non-creditor groups that are in an excellent position to contribute to the detection of harmful phoenix activity. Where feasible, they should have wide access to company and director data that they can collate, digest and disseminate for the benefit of less capable parties. As is noted above, the more that creditors avoid becoming victims of phoenix activity, the smaller the losses that may be suffered by them and the less enforcement action that regulators will be required to undertake.

Despite not being creditors themselves, superannuation funds, trade unions, and credit reporting agencies are arguably the 'canaries in the coal mine' when it comes to harmful phoenix activity. Superannuation funds may notice that a particular employer ceases to remit contributions, well before any individual employees become aware of the non-payment of their own superannuation entitlements. Unions become aware of the non-payment of wages through member complaints. They may know of notorious directors who have resurfaced time and again. For credit reporting agencies, it is the nature of their business to collate and sell credit-related information. Its usefulness is greatly enhanced through comprehensive information, allowing those who otherwise might fall foul of harmful phoenix activity to avoid that fate.

1.5.1 Superannuation

When a company enters liquidation, employees with unpaid entitlements are entitled to claim on the taxpayer-funded FEG,[210] which covers specified amounts of wages, leave and redundancy entitlements. However, superannuation is not covered by FEG.[211]

Superannuation recovery is subject to a peculiar mechanism. The employer is obliged to pay at least the statutory mandated amount[212] to the employee's chosen fund[213] but the fund is not a creditor in the winding up.[214] In practice, the fund might chase the employer for the payment of the superannuation contribution but it can do nothing further if the employer notifies it that the employee has changed funds or is no longer employed. The enforcement of superannuation comes through the superannuation guarantee charge which is administered by the ATO,[215] but the ATO relies on the employer to self-declare their failure to pay.[216] An ATO investigation may be prompted by employee complaints[217] that superannuation has not been paid but for a variety of reasons, the ATO may not initiate recovery action or may be unable to recover the outstanding amount.[218] The employee may be unaware of the non-payment until the employer company becomes insolvent.[219]

Because of the multiple parties involved in superannuation – employee, employer, trade union, superannuation fund, ATO – information sharing is vital to ensure that unremitted payments are followed up as soon as possible.[220] This was recognised by the 2015 SERC Construction Insolvency Report which recommended better liaison between the ATO, ASIC

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210 Department of Employment (Cth), *Fair Entitlements Guarantee* <https://www.employment.gov.au/fair-entitlements-guarantee-feg>.

211 Under s 5 of the *Fair Entitlements Guarantee Act 2012* (Cth), an 'employment entitlement' means annual leave, long service leave, payment in lieu of notice, redundancy pay and wages.

212 This amount is currently 9.5% of eligible wages.

213 *Superannuation Guarantee (Administration) Act 1992* (Cth) pt 3A ('*Super Guarantee (Administration) Act*'), inserted by *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* (Cth) sch 1 item 22.

214 Employees are priority creditors in a liquidation and superannuation is one of the entitlements which are subject to this priority: *Corporations Act* ss 556(1)(e)–(h).

215 *Superannuation Guarantee Charge Act 1992* (Cth).

216 *Super Guarantee (Administration) Act* ss 46, 64A.

217 ATO, *Unpaid Super* <https://www.ato.gov.au/Individuals/Super/In-detail/Growing/Unpaid-super/>.

218 ATO, *Questions You May Have About this Step in the Process* <https://www.ato.gov.au/Individuals/Super/In-detail/Growing/Unpaid-super/?page=4>.

219 See Helen Anderson and Tess Hardy, 'Who Should be the Super Police? Detection and Recovery of Unremitted Superannuation' (2014) 37 *UNSW Law Journal* 162.

220 For example, liquidators report unpaid superannuation entitlements to ASIC (*ASIC Report 507*, above n 157, [97]) yet it is not clear whether this information is then referred on to the ATO. There is no mention of such referrals in the ATO's submission to the Senate committee inquiry into Superannuation Guarantee non-payment: see ATO, Submission No 6 to Senate Economics References Committee, *Inquiry into Superannuation Guarantee Non-payment*, 2016–17, [49]–[53].

and superannuation funds to assist early detection,[221] and that privacy provisions be reviewed to facilitate improved information sharing.[222]

To highlight the importance of the involvement of superannuation funds, in November 2016, a joint report was released by two super funds that estimated at least $3.6 billion of unpaid superannuation in 2013–14.[223] This figure, which covers non-payment by both solvent and insolvent employers, is clearly not confined to phoenix activity, and as an estimate, is as difficult to confirm as the 2012 PwC estimate of the cost of phoenix activity to the economy.[224] External administrators' reports to ASIC for the period 2015-2016 show that in 3,051 administrations out of a total of 9,465 (or 32%), employees' superannuation between $1 and $100,000 was unpaid.[225] At the other end of the scale, there were 19 instances where over $1,000,000 of superannuation was unpaid; there were also 171 instances of unpaid superannuation between $250,001 and $1,000,000.[226]

Lost superannuation due to phoenix activity cannot be accurately quantified for two reasons. First, as noted above, EXAD reports do not report phoenix losses separately from general losses due to insolvency: [1.2.2]. Second, there may be unpaid superannuation in respect of employees of abandoned companies, at [1.3.2], where there is no liquidator conducting an investigation and reporting to ASIC. Superannuation funds, properly empowered to receive and share information, can play a useful role in detecting unpaid superannuation and bringing it to ASIC's attention.

Recommendation 10: Increase information sharing between super funds and regulators

- There should be better liaison between the ATO, ASIC and superannuation funds to assist early detection.
- Privacy provisions should be reviewed to facilitate improved information sharing.

221 *SERC Construction Insolvency Report*, above n 14, recommendation 5, [3.72]: 'The committee recommends that the ATO and ASIC increase their formal cooperation with superannuation funds to coordinate measures around early detection of non-payment of superannuation guarantee.'

222 Ibid recommendation 6, [3.73]: 'The committee recommends that privacy provisions which may inhibit information flows between the ATO and APRA regulated superannuation funds be reviewed and that the ATO seek advice from the Office of the Australian Information Commissioner as to the extent to which protection of public revenue exemptions in the Australian Privacy Principles might facilitate improved information sharing.'

223 Construction and Building Unions Superannuation and Industry Super Australia, *Overdue: Time for Action on Unpaid Super* (November 2016) 3.

224 See Anderson et al, *Quantifying Phoenix Activity Report*, above n 9; PricewaterhouseCoopers, above n 8.

225 ASIC, above n 157, [97].

226 Ibid.

1.5.2 Trade unions

Trade unions, properly known as 'registered organisations', occupy a unique place. On the one hand, they are outsiders to the contract between employer and employee. Corporations and taxation law make no special arrangements for trade unions as participants in policing employers' compliance with their obligations. On the other hand, the *Fair Work Act* expressly recognises the role of unions as defenders of the rights of workers. Section 539 of that Act sets out the many circumstances where 'an employee organisation' enjoys the same rights to bring action that an employee or a Fair Work Inspector does.[227]

The superannuation fund for the building industry, Cbus, submitted to the SERC that 'resourcing limitations continue to curtail the proactive work that the ATO can undertake.'[228] This may have contributed to employees of Cbus giving fund-member information to the fund-members' union, the CFMEU. This improper action was brought to light in 2015 by the Royal Commission into Trade Union Governance and Corruption ('Heydon Royal Commission') in relation to non-payments of superannuation by a company called Lis-Con.[229] While the suggestions above at [1.5.1] might render union involvement in policing superannuation contributions less significant, governments should acknowledge the very useful role that unions can play in detecting harmful phoenix activity.

Because individual employees are unlikely to be in a position to conduct background searches on their employers with the same thoroughness as commercial creditors, there is merit in an expanded role for unions in the fight against harmful phoenix activity. At [1.4.2] we recommended the creation of new online registers of disqualified directors and 'restricted directorships' (see [2.1] for discussion of our proposed director restriction scheme). It is important that the institutions that represent the interests of those who are most likely to become victims of harmful phoenix activity are made aware of the availability of these registers. As such, we recommend that ASIC notify unions of the availability of these registers and request that the unions notify ASIC if it comes to their attention that a disqualified or restricted director is continuing to manage corporations in breach of their disqualified or restricted status.

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227 See generally Tess Hardy, 'Enrolling Non-State Actors to Improve Compliance with Minimum Employment Standards' (2011) 22 *The Economic and Labour Relations Review* 117; Tess Hardy and John Howe, 'Partners in Enforcement? The New Balance between Government and Trade Union Enforcement of Employment Standards in Australia' (2009) 22 *Australian Journal of Labour Law* 306.

228 *SERC Construction Insolvency Report*, above n 14, [3.27].

229 Commonwealth, Royal Commission into Trade Union Governance and Corruption, Submissions of Counsel Assisting, 'CBUS Leak to the CFMEU', 2015.

Recommendation 11: Increase information sharing between trade unions and others

- Information flows about harmful phoenix activity from and to trade unions should be improved.
- Superannuation law should be amended, and guidelines should be developed, to permit the proper exchange of information between trade unions and superannuation funds.
- ASIC should notify unions of the availability of the director disqualification and restriction registers and request that the unions notify ASIC if it comes to their attention that a disqualified or restricted director is continuing to manage corporations in breach of their disqualified or restricted status.

1.5.3 Credit reporting agencies

Where directors of companies are seeking financing to run their businesses, lenders, via the services of a credit reporting agency, would benefit from seeing information about prior tax defaults by companies with which those people have previously been associated.[230] While the ATO can use external debt collection agencies to pursue unpaid taxes,[231] it has not been able to register tax defaults with credit reporting agencies, as a bank or trade creditor might. However, in 2014 the ATO indicated that it would like that information made public. ATO Second Commissioner Geoff Leeper said:

> the fact … a debt to the tax office cannot be disclosed to the markets because of secrecy provisions [means that] there are no credit reference consequences from being in debt to the tax office. … This is a matter for government to consider at some point. The only way around it that we can think of is to propose that the Commonwealth as an entity have the ability to advise a credit market, 'Geoff owes $41,000,' without disclosing the nature of that debt.[232]

In December 2016, the Australian Government announced in its Budget 2016–17 Mid-year Economic and Fiscal Outlook ('MYEFO') that

> [f]rom 1 July 2017, the Government will allow the Australian Taxation Office (ATO) to disclose to Credit Reporting Bureaus the tax debt information of businesses that

[230] In early 2016 we conducted a survey of members of the Australian Institute of Credit Management ('AICM') (see above n 26) and 95% of respondents agreed or strongly agreed that '[h]aving the ATO list all unpaid tax by commercial entities … would significantly enhance my credit approval/declining decision making.' Survey on file with author.

[231] Note the discussion of this issue in Inspector General of Taxation, *Debt Collection: A Report to the Assistant Treasurer* (July 2015) ch 5 ('*IGT Debt Collection Report*').

[232] Evidence to Standing Committee on Tax and Revenue, Parliament of Australia, Canberra, 28 February 2014, 24 (Geoff Leeper).

> have not effectively engaged with the ATO to manage these debts. The ATO does not currently provide this information.[233]

It is proposed that the measure will initially only apply to businesses with ABNs and tax debt of more than $10,000 that is at least 90 days overdue. The measure is estimated to provide a gain of $63 million in underlying cash balance terms over the forward estimates period.[234] This part of the report examines the potential benefits and risks of disclosing tax debts to credit reporting agencies and how this issue has been dealt with in foreign jurisdictions.

The significance of publicly available tax default information is that unpaid taxes are often an early sign of the precariousness of a company and its likelihood of defaulting on other debts. If credit reporting agencies could include this sort of information in their advice to prospective lenders and trade creditors, one significant incentive to engage in phoenix activity – its invisibility – would be undermined.

There are several international examples of tax debts being utilised publicly. As of 1 June 2014, the Estonian tax authority has published a 'black list' of tax debtors who owe at least EUR 1000 of taxes.[235] The list is published on the tax authority's webpage on a monthly basis, although there has been some controversy about the accuracy of debts published on the 'black list'.[236]

In Sweden, the Swedish Enforcement Authority (a subsidiary agency of the Tax Agency) is responsible for collecting both public debts (i.e. debts to central and local authorities, such as taxes) and private debts (based on titles of execution, judgments of general and administrative courts).[237] The Enforcement Authority has direct access to a register of tax debtors kept by the Tax Agency. All public and private debts are recorded in the register. The register is

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233 Australian Government, *Mid-Year Economic and Fiscal Outlook* (December 2016) 113.

234 Ibid.

235 Tax and Customs Board, Republic of Estonia, *Public Databases for Conducting Background Research on Counterparties: Inquiries Available from the Website of the Estonian Tax and Customs Board – Taxes Paid* <https://www.emta.ee/eng/business-client/taxation-payment-taxes/public-databases-conducting-background-research>: 'The Excel spreadsheets that can be opened at the bottom of the page allow you to verify if a person such as your counterparty has paid taxes and in what amount. The tables provide the total amounts of state taxes paid on a quarterly basis by taxable persons (except private individuals) and separate amounts of total employment taxes, contributions to mandatory funded pension and unemployment insurance premiums paid.' See Ants Karu, *Amendments on Estonian Tax Legislation* (20 August 2014) Legal Knowledge Portal <http://legalknowledgeportal.com/2014/08/20/amendments-on-estonian-tax-legislation/>.

236 Toomas Hõbemägi, *Companies Become Tax Debtors because of Problems in e-Tax Board* (12 March 2015) Baltic Business News <http://www.balticbusinessnews.com/article/2015/3/12/companies-become-tax-debtors-because-of-problems-in-e-tax-board>.

237 See Swedish Tax Agency, *Taxes in Sweden: An English Summary of Tax Statistical Yearbook of Sweden* (2012) 17 n 3; Swedish Enforcement Authority, *Information about the Activities of the Swedish Enforcement Authority*, [4.1]–[4.2] <https://www.kronofogden.se/InEnglish.html>.

searchable by name, as well as by personal identity number (for individuals) and company registration number (for companies). Information recorded on the register includes what kind of debt the individual or the company has and what action the Enforcement Authority has taken.[238] A debtor's details remain on the register for three years following payment of the relevant debt.[239]

The public registration of tax debtor details in Sweden was the subject on an application before the European Commission of Human Rights, which considered whether the public registration of tax debtor information contravened Article 8 (Right to Privacy) of the European Convention for the Protection of Human Rights and Fundamental Freedoms. The Commission found that while the registration of the applicant's debt interfered with his right to privacy, having regard to the margin of appreciation left to Swedish authorities, the registration in question 'could reasonably be regarded as "necessary in a democratic society" within the meaning of Article 8 para. 2 (Art. 8-2) of the Convention.'[240] Credit reporting agencies source tax debt information from the public register kept by the Swedish Enforcement Authority. For example, Soliditet, one of Sweden's largest credit reporting agencies, sources tax debt information from the register on a weekly basis.[241]

In recommending access to tax information for credit reporting agencies, we sound a note of caution. It is not an offence to be the director of a company which has failed owing tax debts, nor does it indicate that the director or any company they manage will default in the future. For the release of tax default data to be effective, it must be confined to those who 'genuinely don't deserve more credit'. In other words, if 50% of people have some prior tax default (personal or corporate) against their names, it becomes meaningless to suggest that this information should have a negative effect on their ability to obtain later credit. The recommendations contained in this document are *not* intended to interfere with genuine business rescues or the attempts of a legitimate entrepreneur to start again following a prior corporate failure. If the ATO is to provide tax default information to credit reporting agencies, some restrictions should be put in place to protect legitimate directors from any adverse consequences.

One way to do this would be to tie the release of tax debt information to the 'restricted directorship' mechanism that we recommend at [2.1]. This would reduce significantly the volume of data released to credit reporting agencies, meaning that what they did receive would be more pertinent.

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238 Swedish Enforcement Authority, ibid [4.4].

239 International Business Publications Inc, *Sweden Insolvency (Bankruptcy) Laws and Regulations Handbook: Strategic Information and Basic Laws* (International Business Publications, 2015) 62.

240 *Gedin v Sweden* (1996) 29189/95 <http://echr.ketse.com/doc/29189.95-en-19961127/view/>.

241 See Solidtet, *Our Sources* <http://www.soliditet.se/cms/lang/en_GB/soliditet/AboutSoliditet/Sources>.

In 2012, a report of the United States Government Accountability Office considered reporting tax debts to credit bureaus.[242] It drew no firm conclusions on whether tax debts should be reported but did note that important considerations in making such a decision include the accuracy and currency of the data, the size of the debt, the status of the debt, including whether it is disputed, and the expected costs and benefits of reporting.[243]

Recommendation 12: Provide corporate tax debt data to credit reporting agencies

- The government should continue to explore ways in which useful and accurate amounts of tax debt information could be released to credit reporting agencies.
- We note the government's announcement in the Budget 2016–17 Mid-year Economic and Fiscal Outlook that, from 1 July 2017, it will allow the ATO to disclose to Credit Reporting Bureaus the tax debt information of businesses that have not effectively engaged with the ATO to manage these debts.

1.6 Improve collection of statistical data about phoenix activity

The preceding parts of this report contained a number of recommendations aimed at detecting phoenix activity for the purposes of disrupting and taking enforcement action against harmful phoenix activity. Here we recommend that, whenever incidents of phoenix activity are detected, this information is kept in the form of statistical data so that it is possible to accurately quantify the incidence and economic cost of phoenix activity and thereby develop evidence-based laws, policies and practices to combat harmful phoenix activity.

Based on currently available data, it is not possible to accurately quantify the incidence and economic cost of phoenix activity, or even the enforcement of laws relating to phoenix activity.[244] For a detailed discussion of the data that is (and is not) available, see our previous major report, Quantifying Phoenix Activity: Incidence, Cost, Enforcement. This makes it impossible to develop evidence-based laws, policies and practices, as the only way to test their effectiveness is to determine whether they correlate to a reduction in phoenix activity.

In light of the above, we support the recommendations of the SERC's *Inquiry into the Performance of ASIC* in relation to ASIC's statistical data capabilities and systems:

> 16.44 The committee recommends that ASIC look at the skills it needs to forensically and effectively interrogate its databases and other sources of information it collates and stores, with a view to ensuring that it is well-placed to identify and respond to

[242] US Government Accountability Office, *Report to Congressional Requesters: Federal Tax Debts – Factors for Considering a Proposal to Report Tax Debts to Credit Bureaus* (September 2012).
[243] Ibid.
[244] See Anderson et al, *Quantifying Phoenix Activity Report*, above n 9.

> early warning signs of corporate wrongdoing or troubling trends in Australia's corporate world.
>
> ***
>
> 22.26 The committee is of the view that ASIC should interrogate its databases and extract and publish critical information that would allow academics, professional bodies and interested members of the public to gain a greater understanding of what is happening in the financial world. This requirement to analyse the various databases would also provide ASIC employees with the means to develop and test their analytical skills and capability.
>
> 22.27 The issue of releasing data reaches beyond simply publishing statistics. As identified elsewhere in this report, ASIC does not respond promptly to warning signs of brewing trouble. A part [of the] solution to this problem could well reside in ASIC's ability to analyse its databases and other vital information that it gathers and records. In the committee's view, ASIC should do more than simply record, collate and publish such information. If ASIC were to undertake serious research and critical analysis of the information it receives, it would provide its employees with the opportunity to apply and further hone their skills. They would be well placed to interrogate ASIC's databases in order to discern any troubling trends or identify areas that appear to warrant close scrutiny. In addition, by making available a rich source of statistics and importantly its own analysis of that material, ASIC would benefit from allowing academics and other stakeholders to subject its analysis to further scrutiny and in-depth analysis and to receive informed feedback.[245]

We also support the Inspector-General of Taxation's ('IGT') recommendations that the ATO improve its statistical analysis and metrics in relation to debt collection strategies:

> Recommendation 2.5
>
> The IGT recommends that the ATO:
>
> a. publish further statistical information and analysis, currently only available internally, to better inform the public about tax debt and strategies to address them; and
> b. undertake further statistical analysis to develop improved metrics, which are reported publically, to better describe the effectiveness of its debt strategies in

[245] *SERC Performance of ASIC Report*, above n 92, recommendation 20, [16.44], [22.26]–[22.27].

relation to such issues as improving payment on time, payment behaviour over the longer term and the benefit to the economy.[246]

Better statistical data on the payment of particular tax debts is just one aspect of evidence-based strategies to disrupt harmful phoenix activity. These examples from the SERC and the IGT are cited simply as support for the proposition that it is essential to collate statistical data on phoenix activity in order to know the scale of the problem, how best to address it, and whether existing measures are working.

Recommendation 13: Improve collection of statistical data about phoenix activity

- ASIC, the ATO, the FWO, and other relevant regulators and stakeholders should keep statistical data on the incidence and economic cost of phoenix activity – along with surveillance, investigation and enforcement actions they take in response to such activity – in order to accurately quantify the incidence and economic cost of phoenix activity and develop evidence-based laws, policies and practices that result in an effective reduction of harmful phoenix activity.

[246] *IGT Debt Collection Report*, above n 231, recommendation 2.5, xiv.

2 DISRUPT HARMFUL PHOENIX ACTIVITY

We think harmful phoenix activity occurs because it is invisible, easy, cheap and highly profitable. It is often difficult for regulators to differentiate legitimate business rescues from those tainted with wrongdoing. Even those caught engaging in illegal phoenix activity may suffer no more than a short disqualification. The previous chapter sought to overcome the invisibility issue. This chapter tackles the easiness issue.

We believe that 'disruption' can contribute greatly towards reducing the incidence of harmful phoenix activity. Harmful phoenix activity is illegal phoenix activity or phoenix activity by those who are inept serial entrepreneurs. At the same time, nothing that we recommend here interferes with legitimate business rescues or even an entrepreneur who has suffered a small number of corporate failures.

2.1 Introduce restricted directorships

One way to obstruct harmful phoenix activity is to introduce a new category of directorship for those with a history of multiple failed companies. We call this new category 'restricted directorships'. Under our proposed regime, 'restricted directors' and the companies they control will be subject to a number of additional requirements that are described at [2.1.2].

The introduction of restricted directorships allows the balance to gradually shift from the rehabilitation of a business to the protection of creditors. It is an interim category between unlimited directorships and complete disqualification from managing any companies at all. Genuine entrepreneurs starting a new business are reminded that their company's actions can have adverse consequences for creditors and others. Honest but inept entrepreneurs who have had many prior failures are likely to rethink their plans. Those using incorporation of a new company as a deliberate device to sidestep debts are provided with bothersome hurdles which reduce the attractiveness of phoenix activity.

2.1.1 When the restriction applies

A person who has been an officer of five corporations that have either failed (as currently defined in *Corporations Act* s 206D(2)) or been deregistered at ASIC's instigation (under ss 601AB(1)–(2))[247] within the previous 10 years should be subject to an automatic restriction for a period of five years. Every corporation of which a 'restricted director' is a director or

[247] Corporations deregistered at ASIC's instigation are discussed at [1.3.2].

secretary at the time the restriction is imposed, and every additional corporation that the person becomes a director or secretary of within the restricted period, would be deemed to be a 'restricted company'.

We take into account a range of factors in setting the appropriate number of past failures or ASIC-instigated deregistrations at which the restriction should be imposed. The *Corporations Act* contains two sections that allow disqualification action to be taken against directors who have been involved in two or more corporate failures within the previous seven years. Section 206D allows ASIC to apply for court ordered disqualification in certain circumstances when a person has been an officer of two or more corporations that have failed within the previous seven years. Section 206F allows ASIC to directly disqualify persons who have been officers of two or more corporations that have been wound up within the previous seven years. These sections require additional elements to be present and the exercise of discretion by ASIC and/or the court before a director can be disqualified. The proposed restriction would apply automatically upon the occurrence of a prescribed number of corporate failures or deregistrations at ASIC's instigation. For that reason, and to ensure that genuine entrepreneurs are not inhibited, two prior corporate failures is not an appropriate threshold for the restriction.

In our view, five prior corporate failures or ASIC-instigated deregistrations within the previous 10 years would be an appropriate threshold at which a person should be restricted. Given that five are required, rather than the two failures required under ss 206F and 206D of the *Corporations Act*, we consider it appropriate to extend the time limit within which the failures or deregistrations must have occurred from seven to 10 years. Once an individual has been a director of a total of five corporations that have either failed or been deregistered at ASIC's instigation, that person should be deemed a 'restricted director'.

The five-year period of restriction is consistent with the duration of the automatic disqualification mechanism under s 206B of the *Corporations Act*. Should a restricted director be a director or secretary of an additional company that fails within the five-year restriction period, that period should be extended automatically until a date that is five years from the date of the last corporate failure. In other words, the restriction period will not lapse until five years has passed since the restricted director's last corporate failure, thereby seeking to ensure that the pattern of corporate failures does not continue. When the restricted period has lapsed, the restriction is automatically lifted. Of course, there is nothing to stop ASIC bringing a disqualification action under ss 206F or 206D of the *Corporations Act* or other forms of legal action against restricted directors, so the proposed automatic extension of the restriction period is not the only safeguard against repeated harmful corporate failures.

Restricted directors should be given the right to apply to the Court for an order to set aside or vary the restriction, just as s 206G of the *Corporations Act* provides that a person who is disqualified from managing corporations (including those who are automatically disqualified under s 206B) has the right to apply to the Court for leave to manage all or specified corporations, provided that the person was not disqualified by ASIC.[248]

2.1.2 Consequences of the restriction

The following parts contain a discussion of the additional requirements that should be imposed on restricted directors and restricted corporations. Some restrictions are designed to limit the number of companies and thereby the number of creditors that are exposed to the risk of dealing with restricted directors. These restrictions include a limit on the number of concurrent directorships restricted directors may hold, increased reporting requirements and increased monitoring and surveillance by regulators.

Each of the recommendations below depends upon ASIC maintaining a register of restricted directors and restricted corporations: [1.4.2], as it is not possible to monitor compliance with the conditions of a restricted directorship without such a register. As discussed above at [1.4.2], ASIC should make the register publicly available. Clearly the register would also be of great use to other regulators in choosing subjects for further investigation or more vigorous enforcement.

2.1.2.1 Limits on the number of concurrent directorships

The lack of a ceiling on the number of directorships an individual may hold at a given time can facilitate harmful phoenix activity. While a ceiling would not prevent harmful phoenix activity, it may limit the damage caused by such activity by restricting the number of companies that the individual is able to 'phoenix' at any given time. The threat of the imposition of such a limit may also deter would-be phoenixers who are approaching the threshold at which they may be restricted.

Ireland is a jurisdiction that limits the number of directorships an individual may hold at any given time: 'A person shall not … be a director of more than: 25 private companies limited by shares; or 25 companies, one, or more than one, of which is a private company limited by

[248] Section 206G does not apply to disqualification by ASIC pursuant to s 206F; however, it does apply to persons who are automatically disqualified pursuant to s 206B: see *Phillips and Inspector-General in Bankruptcy [2012] AATA 788*, [200].

shares and one, or more than one, of which is any other type of company capable of being wound up under this Act.'[249]

We do not suggest this kind of broad limit on the number of directorships for everyone. However, a limit of five should be introduced on the number of concurrent directorships for restricted directors because of their prior history of corporate failures. Where the number of directorships held at the time of restriction exceeds the limit, the restricted director should be required to bring themselves within the prescribed limit within a set period of time.

Like many of our recommendations, the restriction recommendation will only be effective if it is able to be enforced, and that requires a workable DIN: [1.1.1]. The DIN would mean that ASIC would have data on the number of directorships held by restricted directors at any given time, so it can deal with those persons who attempt to exceed the limit.

2.1.2.2 Increased reporting and interaction with regulators

Interaction with the regulator can encourage greater compliance with regulatory requirements and discourage non-compliant behaviour. Kingsford Smith argues that regular contact with the regulator is especially important in circumstances where the regulated community is large and non-compliance is difficult to detect.[250] This is the case with harmful phoenix activity.

One form of interaction with the regulator is reporting. Restricted directors and restricted corporations should be made subject to increased reporting requirements. This would have the advantage of providing increased opportunity for regulators to detect difficulties as well as sending the message to restricted directors that they are being monitored.

At present, s 292 of the *Corporations Act* requires an annual financial report and a directors' report containing prescribed information for, inter alia, public companies and large proprietary companies. Restricted companies of these types could be required to submit these reports to ASIC twice as frequently. Small proprietary companies[251] are not required to report

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249 *Companies Act 2014* (Ireland) s 142(1).

250 Dimity Kingsford Smith, 'A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector' (2011) 44 *University of British Columbia Law Review* 695, 695. See also Christine Parker and Vibeke Lehmann Nielsen, 'Do Businesses Take Compliance Systems Seriously? An Empirical Study of the Implementation of Trade Practices Compliance Systems in Australia' (2006) 30 *Melbourne University Law Review* 441, 464. Parker and Nielsen found that businesses were more likely to fully implement compliance programs when they had been subject to investigation or enforcement by the regulator, in this case the ACCC: at 482.

251 A 'small proprietary company' is defined as a company that satisfies at least two of the following three criteria: consolidated revenue of less than $25 million; consolidated assets of less than $12.5 million; and fewer than 50 employees: see *Corporations Act* s 45A(2).

unless shareholders or ASIC direct them to do so.[252] These are the sorts of companies that are the most likely to be phoenixed and to be run by directors who qualify for restriction. Small proprietary companies run by restricted directors could be automatically directed to produce and lodge these reports. This saves ASIC the task of making the direction.

Restricted companies could be required to lodge their business activity statement ('BAS') and remit their PAYG(W)[253] and GST amounts more frequently. Businesses holding ABNs which are registered for the GST are required to lodge their BAS by a due date.[254] The current requirements are that businesses with an annual turnover of $20 million or more must report and pay GST monthly and those with an annual turnover of less than $20 million must report and pay GST quarterly, unless the ATO has advised them otherwise.[255] Restricted company status could generate an automatic requirement to report monthly. Again, the benefit achieved is that it saves the ATO the task of selecting these candidates for more frequent reporting and makes the restricted directors and their companies more conscious of the fact that their activities are subject to heightened scrutiny.

In addition to the requirements suggested above, regulators should prioritise restricted directors and restricted corporations when they are designing their surveillance and inspection programs. The ATO already targets high risk people, conducts surprise visits to businesses and residential properties connected with suspected phoenix operators[256] and has a history of conducting random audits of businesses and individual taxpayers in order to detect tax evasion.[257] Regulators such as the ATO, ASIC and the FWO could access the restricted director register to target their inspections and audits appropriately.

2.1.2.3 Education for restricted directors

Consideration could be given to education for directors who are subject to restriction. Rather than requiring directors to undertake some sort of remedial training, directors could reduce the length or conditions of their restriction by voluntarily undertaking education that helps

252 *Corporations Act* ss 292–294.

253 At [2.7] we recommend that PAYG(W) taxes and superannuation contributions be remitted to the ATO and superannuation fund respectively at the same time the employee is paid.

254 ATO, *Business Activity Statements* <https://www.ato.gov.au/Business/Business-activity-statements-%28BAS%29/>.

255 ATO, *Options for Reporting and Paying GST* <https://www.ato.gov.au/Business/GST/Lodging-your-BAS-or-annual-GST-return/Options-for-reporting-and-paying-GST/>.

256 See, eg, ATO, 'ATO Swoops on Phoenix Businesses' (Media Release, 11 June 2015); ATO, 'Phoenix Taskforce Swoops on Pre-Insolvency Industry' (Media Release, 12 August 2016).

257 See, eg, Nassim Khadem, 'Tax Man to Hit SMEs and Individuals with Random Audits', *The Sydney Morning Herald* (Sydney), 5 November 2015.

them become more responsible and capable directors. This removes the enforcement burden on ASIC. We note this recommendation from the Inspector General of Taxation:

> The IGT recommends that the ATO:
>
> a. jointly develop with other relevant agencies, a suite of educative materials for small business owners on their legal responsibilities; and
> b. continue to implement and refine the integrated risk treatment plan, for phoenix activity across the organisation, which incorporates the new inter–agency powers, engagement with intermediaries and assessment tools for measuring the success of the plan.[258]

2.1.3 Penalties for failure to comply with the requirements of restricted directorships

Just as failure to comply with an order disqualifying a person from managing corporations is subject to penalties under s 206A of the *Corporations Act*: [2.2.4], there must also be penalties for failure to comply with the requirements of restricted directorships. For example, these penalties would apply where a restricted director holds more that the permitted number of concurrent directorships: [2.1.2.1] or does not comply with increased reporting requirements: [2.1.2.2].

Failure to comply with the requirements of restricted directorships should attract the following penalties:

- A fine of up to 100 penalty units (currently $18,000)[259] or imprisonment for up to 2 years, or both, which ought to be prosecutable either by ASIC using its summary prosecution power[260] or by the CDPP; and/or
- ASIC-ordered disqualification from managing corporations for up to 10 years.

These penalties are similar to the amendments that we propose to s 206A of the *Corporations Act* with regard to the penalties for managing corporations while disqualified under provisions that do not require a judicial determination of wrongdoing (e.g. ss 206B(3)–(4), 206F or 206D): [2.2.4].

Recommendation 14: Introduce restricted directorships

- A person who has been an officer of five corporations that have either failed (as currently defined in *Corporations Act* s 206D(2)) or been deregistered at ASIC's

[258] *IGT Debt Collection Report*, above n 231, recommendation 2.4, xiv.

[259] The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

[260] For an explanation of ASIC's summary prosecution power, see below n 303 and accompanying text. See also above n 88 and accompanying text.

instigation pursuant to *Corporations Act* s 601AB within the previous 10 years should automatically be subject to restriction for a period of five years.

- Any corporation of which a restricted director is a director or secretary should be deemed to be a restricted corporation.
- Where a restricted corporation fails during the restriction period, the period for which the director is restricted should be extended automatically until a date that is five years from the date of that failure.
- Restricted directors should be able to apply to the court for an order to set aside or vary the restriction.
- Director restriction should result in the following consequences:
    - the number of directorships a restricted director may hold at any given time should be limited to five;
    - restricted directors and restricted corporations should be subject to increased reporting requirements;
    - relevant regulators should prioritise restricted directors and restricted corporations when they are designing surveillance and inspection programs; and
    - consideration should be given to the possibility of allowing directors to reduce the length of their restriction or the conditions imposed upon them by voluntarily undertaking recognised education that helps them become more responsible and capable directors.
- Failure to comply with the requirements of restricted directorships should attract a fine of up to 100 penalty units or imprisonment for up to 2 years or both, and/or ASIC-ordered disqualification from managing corporations for up to 10 years.

2.2 Strengthen the director disqualification regime

The power to disqualify people from managing corporations is one of the most important legal mechanisms available for disrupting harmful phoenix activity, as it can be used to take those at risk of engaging in harmful phoenix activity out of the market altogether. ASIC can make disqualification orders itself under certain circumstances[261] and also has broad powers to apply to the court for disqualification orders.[262] In some circumstances, disqualification orders can be made against people who have engaged in, or are suspected of having engaged in, illegal phoenix activity or other forms of corporate and financial wrongdoing.[263] In other circumstances, they can be made against people solely because of their involvement in

[261] *Corporations Act* s 206F.
[262] Ibid ss 206C, 206D, 206E, 206EAA.
[263] Ibid ss 206C, 206E, 206EAA.

multiple companies that have failed owing money to creditors.[264] These include our 'serial inept entrepreneurs'.

In addition to disqualification orders made by ASIC or the courts, people who have been convicted of certain offences are automatically disqualified from managing corporations by operation of law.[265] It is a criminal offence to manage corporations while disqualified[266] punishable by a fine of up to 50 penalty units (currently $9,000),[267] imprisonment for up to 1 year, or both, under the *Corporations Act*,[268] among other penalties applicable under the *Crimes Act 1914* (Cth).

The purposes of disqualification orders are the protection of the public and the maintenance of standards in the management of corporations. However, orders that are imposed on the basis of some form of proven or alleged wrongdoing may also have the effect of being punitive.[269] Our view is that the disqualification regime has the potential to play a central role in disrupting harmful phoenix activity and taking action against those who have engaged in such activity. However, there are a number of deficiencies in the regime that, if remedied, would make the regime significantly more effective in minimising harmful phoenix activity. We recommend measures to address these deficiencies below.

2.2.1 Prioritise director disqualification in the phoenix context

To effectively disrupt and deter harmful phoenix activity, it is critical that regulators make full use of the availability and scope of powers to disqualify people from managing corporations where they have been involved in unlawful conduct or repeated corporate failures. To this end, we recommend at [2.2.3] that the ATO and FWO be given the power to seek court-ordered disqualification to assist ASIC in this important area of enforcement. However, as the corporate regulator, primary responsibility for the disqualification regime rests with ASIC. We have concerns regarding the infrequency and leniency of disqualification orders currently imposed and sought by ASIC in factual settings involving phoenix activity.[270]

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264 Ibid ss 206F, 206D.

265 Ibid s 206B.

266 Ibid s 206A.

267 The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

268 Ibid sch 3 item 49.

269 See Robert P Austin and Ian M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis Butterworths, 2015) 265–6; *Murdaca v Australian Securities and Investments Commission* (2009) 73 ACSR 276, [101]; *Visnic v Australian Securities and Investments Commission* (2007) 231 CLR 381, [11], [26]; *Rich v Australian Securities and Investments Commission* (2004) 220 CLR 129, [47]–[50].

270 The data discussed in this part of the report relates only to management disqualification orders made by the courts and ASIC in factual settings involving phoenix activity. This is just a small subset of the total

We have only been able to identify one matter in which ASIC successfully sought court ordered disqualification in the context of phoenix activity: *ASIC v Somerville*.[271] ASIC sought a disqualification order of 12 years against the legal advisor defendant in *Somerville* but the court considered this 'excessive and unnecessarily punitive' and made a disqualification order of six years instead.[272] The director defendants each received disqualification orders of two years.[273] One of the director defendants was subsequently suspected of involvement in managing corporations while disqualified and on 13 December 2012 entered into an enforceable undertaking with ASIC restraining him from managing specified corporations for a further two years.[274]

As discussed at [1.4.2], comprehensive data on disqualification orders imposed by ASIC under s 206F of the *Corporations Act* is not available to the public. It is therefore impossible to know precisely how many s 206F orders have been made in the context of phoenix activity. However, in a search of ASIC's media releases from 1 January 2004 to 30 June 2014, we found 32 media releases reporting that 51 directors were disqualified under s 206F in circumstances involving harmful phoenix activity.[275] This amounts to an average of about 4.9 orders reported in ASIC's media releases per year. The average duration of these orders was 3.8 years and the median was 4 years, out of a maximum duration of 5 years.

We have concerns that the use of disqualification powers in the phoenix context may be insufficient to achieve effective disruption and deterrence of harmful phoenix activity. In 2015–16, ASIC received 7,797 initial reports from external administrators alleging 20,625 possible incidents of misconduct.[276] In this context, an annual average of 4.9 reported s 206F orders at an average duration of 3.8 years seems inadequate.

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number of management disqualification orders. Based on our empirical research of disqualification orders during the period 1987 to 2015, we estimate that there were about 19 judicial and 50 administrative management disqualification outcomes per year. There were 1,992 management disqualification outcomes in total during the 29-year study period (an average of 69 per year) and our research of ASIC media releases suggests that about 73% of management disqualification outcomes arise from administrative decisions under s 206F (an average of 50 per year), leaving about 27% that arise predominantly from judicial decisions under ss 206C, 206D and 206E (an average of 19 per year). However, the percentages of judicial and administrative disqualification outcomes are only rough estimates, as ASIC media releases are only available from 2001 onward and do not comprehensively cover disqualification orders: see above n 193 and accompanying text.

271 *ASIC v Somerville* [2009] NSWSC 934; *ASIC v Somerville* (No 2) [2009] NSWSC 998.

272 *ASIC v Somerville* (No 2) [2009] NSWSC 998, [36]–[37].

273 Ibid [37].

274 ASIC, *Enforceable Undertaking 027958955: Simon Durant* (13 December 2012); ASIC, 'Legal Adviser and Company Directors Found Liable in Relation to "Phoenix" Activity' (Media Release, 09-174AD, 14 September 2009) editor's note 3.

275 For further discussion of data on s 206F orders made in the context of phoenix activity, see Anderson et al, *Quantifying Phoenix Activity Report*, above n 9, 67–8.

276 *ASIC Report 507*, above n 157, [41].

In part, this problem is a reflection of what arguably is an inadequate use of disqualification powers more broadly in Australia, especially when compared with the UK. The UK has a significantly greater number of companies (3,833,469)[277] than Australia (2,429,200)[278] so we would expect to see a higher rate of disqualification in the UK. However, even taking into account the population difference, there is a much higher rate of disqualification in the UK than Australia. If both disqualification orders and undertakings are included, more people have been disqualified from managing corporations in the UK in the past *two* financial years – 2,420[279] – than the 1,992[280] people who were disqualified in Australia during the 29-year period from 1987 to 2015.[281]

Recommendation 15: Prioritise director disqualification in the phoenix context

- ASIC should prioritise the use of existing disqualification powers to disrupt and deter harmful phoenix activity.

2.2.2 Increase the maximum duration of ASIC disqualification orders

Section 206F of the *Corporations Act* provides that ASIC may disqualify a person from being involved in the management of corporations for up to five years if they have been an officer of two or more failed corporations in the previous seven years, among other conditions.[282] Media release data suggests that the average duration of management disqualification orders in factual settings involving phoenix activity – at 3.8 years – is slightly higher than the general average of 3.5 years.[283] However, we believe the duration of management disqualification orders in general, and in the context of phoenix activity, is insufficient to provide the protection of the public that such orders are intended to provide, as discussed at [2.2].

277 UK Companies House, *Incorporated Companies in the UK: October to December 2016* (26 January 2017) <https://www.gov.uk/government/statistics/incorporated-companies-in-the-uk-october-to-december-2016>.

278 ASIC, *2017 Company Registration Statistics* <http://asic.gov.au/regulatory-resources/find-a-document/statistics/company-registration-statistics/2017-company-registration-statistics/>.

279 See UK Insolvency Service, *Insolvency Service Enforcement Outcomes Monthly Data Tables: December 2016* (13 January 2017) <https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-monthly-data-tables-december-2016>.

280 The number is a little over 2,000, if voluntary bans agreed to by directors as part of enforceable undertakings are included in the dataset.

281 See above n 270.

282 *Corporations Act* s 206F.

283 The average duration of 3.5 years is calculated based on 1,992 management disqualification outcomes during the 29-year period from 1 January 1987 to 31 December 2015. Data collected from ASIC's media releases suggests that a little under three quarters of management disqualification orders are orders made pursuant to s 206F or appeals from such orders, while the remaining orders are mostly made by the courts pursuant to ss 206C, 206D and 206E. For further discussion of this data, see above n 270.

By way of comparison, the average duration of management disqualification orders in Australia is about half that of such orders in the UK, where the average ranged from 6.9 to 7.8 years during the period 2009-10 to 2015-16.[284]

To strengthen ASIC's disqualification regime, the maximum disqualification period under s 206F should be increased to 10 years. In some circumstances, courts can ban a person permanently from managing companies[285] and ASIC has the power to ban a person permanently from providing financial services under s 920A of the *Corporations Act* or engaging in credit activities under s 80 of the *National Consumer Credit Protection Act 2009* (Cth). In this context, raising the maximum disqualification period under s 206F to 10 years is a modest amendment that nevertheless has the potential to play a significant role in disrupting harmful phoenix activity.

Recommendation 16: Increase the maximum duration of ASIC disqualification

- The power of ASIC under s 206F of the *Corporations Act* to disqualify a person from managing corporations for up to five years should be amended so that ASIC has the power to disqualify a person from managing corporations for up to 10 years.

2.2.3 Give disqualification powers to other regulators

2.2.3.1 Fair Work Ombudsman

The FWO is concerned with its limited enforcement powers. Its 2015 submission to the Productivity Commission's Draft Report on the Workplace Relations Framework noted the capacity for corporate insolvency to undermine the FWO's compliance work,[286] and its reliance on 'creative steps within its own jurisdiction'[287] to provide effective deterrents.

In *Transport Workers' Union of Australia (NSW Branch) v No Fuss Liquid Waste Pty Ltd*,[288] Flick J found that the general power to 'make any order the court considers appropriate' under s 545 of the *Fair Work Act* did not extend to a power to disqualify a director. We

284 See UK Insolvency Service, above n 279.

285 Ibid ss 206C, 206E, 206EAA.

286 FWO, Submission No DR368 to Productivity Commission, *Inquiry into Workplace Relations Framework*, 18 September 2015, 5.

287 Ibid. Note the making, for the first time, of an order garnisheeing the wages of a director for an unpaid penalty: *Fair Work Ombudsman v Sona Peaks Pty Ltd (No 3)* [2016] FCCA 615. In *Fair Work Ombudsman v James Nelson Pty Ltd* [2016] FCCA 531, the pecuniary penalty against the director was paid to the Commonwealth, not the company's employees, but an order was made restraining the director from being concerned in conduct in respect of employees employed in the textile industry that contravenes the *Fair Work Act*. Any pecuniary penalty payable by a director under the *Fair Work Act* is not provable in bankruptcy: *Fair Work Ombudsman v Al Hilfi* [2016] FCA 193, [47]–[50].

288 [2011] FCA 982, [43]–[48].

believe the FWO should have more direct mechanisms to sanction errant directors, and an important one would be providing it with the power to seek court-ordered disqualification.[289] This would avoid the double-handling of a matter that currently exists where the behaviour must be referred to ASIC for investigation and disqualification action. We cannot see any justification in restricting the right to seek court-ordered disqualification to ASIC. In the UK, even a liquidator can seek a director's disqualification.[290] The Australian Competition and Consumer Commission ('ACCC') may seek a person's disqualification.[291] Section 86E of the *Competition and Consumer Act 2010* (Cth) provides that:

> (1) On application by the Commission, the Court may make an order disqualifying a person from managing corporations for a period that the Court considers appropriate if:
>
> (a) the Court is satisfied that the person has contravened, has attempted to contravene or has been involved in a contravention of Part IV [restrictive trade practices]; and
>
> (b) the Court is satisfied that the disqualification is justified.

The ACCC also has disqualification powers under s 248 of sch 2 of the *Competition and Consumer Act 2010* (Cth) in relation to consumer law contraventions. Section 206EA of the *Corporations Act* provides that a person is disqualified from managing companies if a court order disqualifying the person from managing companies is in force under s 86E or s 248 of sch 2 of the *Competition and Consumer Act 2010* (Cth).

We recommend that the FWO be empowered to seek court-ordered disqualification against a person for a period the court considers appropriate where (a) the court is satisfied that the person has contravened, has attempted to contravene or has been involved in a contravention of the *Fair Work Act*; and (b) the court is satisfied that the disqualification is justified.

2.2.3.2 Australian Taxation Office

The ATO should also have the power to seek court-ordered disqualification in appropriate circumstances given its important role in disrupting harmful phoenix activity. Where a director has allowed their company to accrue taxation liabilities, has breached their duty to ensure they are paid, and has not sought the company's external administration within the

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289 See Helen Anderson, 'Corporate Insolvency and the Protection of Lost Employee Entitlements: Issues in Enforcement' (2013) 26 *Australian Journal of Labour Law* 75, 100. See also Tom Middleton, 'Banning, Disqualification and Licensing Powers: ACCC, APRA, ASIC and the ATO – Regulatory Overlap, Penalty Privilege and Law Reform' (2015) 33 *Company and Securities Law Journal* 555, 556, 568.

290 *Company Directors Disqualification Act 1986* (UK) s 16(2).

291 The Director of Public Prosecutions can also seek court-ordered disqualification under the *Competition and Consumer Act 2010* (Cth) for certain cartel related offences: s 86E(1A).

prescribed time period, it is appropriate that the Commissioner can recover those amounts from the directors personally via a director penalty notice ('DPN'). This is discussed further at [2.6]. In our opinion, allowing the Commissioner to seek the disqualification of that person from managing corporations is a useful adjunct to that penalty. The financial benefit from the behaviour is removed via the DPN, the Commissioner's loss is redressed, and the marketplace benefits from the removal of a person who has failed to understand their taxation responsibilities.

However, the grounds upon which disqualification is sought must differ from those used by the ACCC and those recommended for the FWO. This is because the insolvent company's failure to pay tax is not a contravention of tax law *by the director*. This is similar to the difficulties with directors' accessory liability for tax crimes discussed in [5.1.5].

One way around this is to base the disqualification provision on the director penalty regime contained in div 269 of sch 1 of the *Taxation Administration Act 1953* (Cth), discussed in [2.6]. Division 269 imposes a duty on directors to ensure that the company meets various taxation obligations or promptly enters liquidation or voluntary administration. A new subsection could be inserted into s 269-20 empowering the ATO to seek a disqualification order against a director in the event that they fail to meet such obligations.

We recommend that the ATO should be empowered to seek court-ordered disqualification against a person for a period the court considers appropriate where (a) the court is satisfied that the person has failed to discharge a duty under div 269 of sch 1 of the *Taxation Administration Act*; and (b) the court is satisfied that the disqualification is justified.

Recommendation 17: Give other regulators the power to seek disqualification orders

- The FWO should be empowered to seek court-ordered management disqualification where a person has contravened, attempted to contravene or been involved in a contravention of the *Fair Work Act* and the disqualification is justified.
- The ATO should be empowered to seek court-ordered management disqualification where a person has failed to discharge a duty under Division 269 of Schedule 1 of the *Taxation Administration Act* and the disqualification is justified.

2.2.4 Increase the maximum penalties for managing corporations while disqualified

Section 206A of the *Corporations Act* provides that it is a criminal offence for a person who is disqualified from managing corporations to do any of the following:

- make, or participate in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or
- exercise the capacity to affect significantly the corporation's financial standing; or
- communicate instructions or wishes (other than advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation) to the directors of the corporation, knowing that the directors are accustomed to act in accordance with the person's instructions or wishes, or intending that the directors will act in accordance with those instructions or wishes.

Schedule 3 to the *Corporations Act* provides that an offence committed under s 206A is punishable by a fine of up to 50 penalty units, which currently amounts to $9,000,[292] or imprisonment for up to 1 year, or both, per offence. There is also a range of penalties under the *Crimes Act 1914* (Cth) that can be imposed, such as good behaviour bonds, community service orders, intensive correction orders, and so on.

In practice, however, the penalties imposed are significantly more lenient than the statutory maximum penalties. ASIC's summary prosecution reports, which ceased being published in 2011,[293] reported outcomes of ASIC's prosecutions under s 206A. The available reports cover the period from July 2005 to December 2010, during which the following outcomes were reported for breaches of disqualification orders: 13 fines ranging from $500 to $10,000 (at an average of $3,277 per fine), three good behaviour bonds, and one intensive correction order.

In regard to s 206A cases prosecuted by the CDPP rather than ASIC, a search for '206A' in ASIC's media release database (2001 to present) yielded three matters in which the defendants had been fined $1,200,[294] $2,000[295] and $3,000.[296] A search for 'managing companies while disqualified' yielded a further three matters resulting in a two year good behaviour bond in the amount of $1,000,[297] a two year good behaviour bond with a special condition that the perpetrator pay $10,000 into the Court fund,[298] and a fine of $15,000.[299]

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292 The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

293 See ASIC, *Summary Prosecutions of Companies and Directors* <http://asic.gov.au/online-services/search-asics-registers/additional-searches/summary-prosecutions-of-companies-and-directors/>. For further discussion of ASIC's summary prosecution reports, see [3.3].

294 ASIC, 'Banned Director Sentenced' (Media Release, 04-012, 19 January 2004).

295 ASIC, 'Former Melbourne Director Convicted of Managing a Corporation While Disqualified' (Media Release, 11-208AD, 21 September 2011).

296 ASIC, 'Disqualified Melbourne Man Convicted' (Media Release, 04-269, 20 August 2004).

297 ASIC, 'Recruitment Specialist Convicted of Managing Companies While Disqualified' (Media Release, 16-424MR, 7 December 2016).

298 ASIC, 'Solicitor Sentenced after Pleading Guilty to Aiding and Abetting Corporate offending' (Media Release, 11-288AD, 9 December 2011).

299 Ibid, 'Background'.

Most recently, a Tasmanian winemaker was fined $2,500 for three charges of managing companies while disqualified as a result of being convicted of a 'crime involving dishonesty' in 2010.[300]

These results suggest that people rarely, if ever, serve actual prison time for committing an offence under s 206A and the financial penalties are usually significantly lower than the current statutory maximum of $9,000 per offence.

The lenient penalties for managing companies while disqualified reveal a striking inconsistency between the severity of the disqualification and the severity of the penalties. For example, company managers' unlawful behaviour has sometimes been so egregious that the court has made an order that *permanently* disqualifies them from managing companies.[301] This is the most severe penalty that can be imposed except for a term of imprisonment. Yet if the people subject to such orders continue to manage corporations, they face penalties that are much more lenient than the disqualification order itself, given that prison sentences are rarely, if ever, imposed. The outcome of this inconsistency is that the protective and deterrent effect of the disqualification regime is lost. A permanent disqualification order seems like a tough enforcement outcome, but not when it is backed up by an average fine of $3,277.

Of course, not all disqualification orders are imposed on the basis of serious unlawful conduct. By far the most common form of disqualification order – orders by ASIC pursuant to s 206F – can be made simply because of involvement in two failed companies, among other conditions, with no suggestion of unlawfulness. This may explain why the penalties for an offence under s 206A are set very low – because it would be perceived as unfair to impose a substantial criminal penalty on a defendant who may not have been disqualified for unlawful conduct.

One way to address this perceived unfairness is to create a separate provision, s 206AA, that deals with breaches of disqualification outcomes that arise from a judicial determination of wrongdoing (e.g. ss 206B(1), 206C, 206E). The penalties for breaches of this type could be set at the same level as the criminal penalties for breaches of directors' duties (see [3.4.2.1]). By contrast, the increase in the penalties for breaches of disqualification outcomes that do not require a judicial determination of wrongdoing (e.g. ss 206B(3)–(4), 206F and 206D) could

[300] ASIC, 'Winemaker Convicted for Managing while Disqualified' (Media Release, 17-028MR, 10 February 2017).

[301] Our research indicates that there were 22 permanent management disqualification orders during the 29-year period from 1 January 1987 to 31 December 2015.

be more moderate, such as twice the current penalty; that is, a maximum fine of 100 penalty units (currently $18,000)[302] or prison sentence of 2 years, or both.

The lower penalties for breaches of disqualification provisions that do not require a judicial determination of wrongdoing ought to be prosecutable either by ASIC using its summary prosecution power[303] or by the CDPP. The reason for allowing ASIC to prosecute breaches of such provisions is to ensure that the lesser deterrent effect of the lower penalties is counterbalanced by the more frequent rate of prosecution that can be achieved by both regulators working in tandem.[304]

This bifurcated approach would ensure that the disqualification regime retains its protective and deterrent effect in relation to more serious cases of misconduct but at the same time does not create the possibility of excessively harsh punishments for those who breach disqualification outcomes where the disqualification has resulted from corporate failures rather than misconduct.

In addition to criminal penalties for managing corporations while disqualified, s 206F of the *Corporations Act* should be amended to give ASIC the power to extend a disqualification period by up to 10 years if a person manages corporations while disqualified under Part 2D.6 and the extension is justified.[305] This should be an independent, administrative power that is not contingent on the person being convicted under s 206A or the proposed s 206AA. That

302 The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

303 The principles governing ASIC's summary prosecution power are set out in the Memorandum of Understanding ('MOU') between ASIC and the CDPP: ASIC and CDPP, *Memorandum of Understanding* (1 March 2006) [7.1]–[7.3]. The offences most commonly prosecuted by ASIC using this power – ss 475 and 530A of the *Corporations Act* – attract a maximum custodial sentence of six months and one year respectively. ASIC rarely prosecutes matters that involve an offence that is punishable by more than one year of imprisonment, perhaps because the MOU provides that ASIC must refer matters that involve a reasonable prospect of a custodial sentence to the CDPP for consideration as to whether prosecution is warranted: ibid [7.2(f)]. However, in some instances ASIC has prosecuted offences under ss 590(1) and 1308(2) of the *Corporations Act*, which attract maximum custodial sentences of two and five years respectively: see ASIC, above n 293, reports dated 4 February 2010, 29 April 2010, 7 October 2009, 28 February 2008, 25 January 2006 and 3 February 2010. This shows that it is possible, in principle, for ASIC to be involved in prosecuting the proposed offence for breaches of ss 206B, 206F and 206D, which would attract a maximum custodial sentence of two years, although this would be subject to agreement between ASIC and the CDPP in accordance with the MOU: ibid [7.1].

304 See [3.2] for further discussion of the importance of the frequency of enforcement action in achieving general deterrence.

305 In the UK managing a corporation while disqualified constitutes a criminal offence punishable by fines and/or imprisonment and can lead to a further disqualification order of up to 15 years in some circumstances: *Company Directors Disqualification Act 1986* (UK) ss 13, 2(3)(b). See UK Insolvency Service, 'Two Mark One Directors Jailed for Controlling Companies Whilst Disqualified' (Press Release, 17 October 2014); UK Insolvency Service, 'Director Duo Tested to Destruction and Flushed Out' (Press Release, 27 July 2016); UK Insolvency Service, 'Door Slams Shut for Disqualified Director' (Press Release, 30 January 2015, updated 8 February 2017). Contravention of disqualification orders in the UK also renders the director personally liable for the debts of the company: *Company Directors Disqualification Act 1986* (UK) s 15.

said, whether or not a person has also been convicted of an offence under s 206A or the proposed 206AA would of course be a factor that the ASIC delegate would need to consider in determining whether extension of the disqualification period is justified.[306] We recommend the insertion of a new s 206F(1A)[307] into s 206F, as follows:

(1A) ASIC may extend by up to an additional 10 years the period of disqualification that applies to a person who is disqualified from managing corporations under this Part if:

(a) they make, or participate in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or

(b) they exercise the capacity to affect significantly the corporation's financial standing; or

(c) they communicate instructions or wishes (other than advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation) to the directors of the corporation:

(i) knowing that the directors are accustomed to act in accordance with the person's instructions or wishes; or

(ii) intending that the directors will act in accordance with those instructions or wishes; and

(d) ASIC has given the person:

(i) a notice in the prescribed form requiring them to demonstrate why their disqualification period should not be extended; and

(ii) an opportunity to be heard on the question; and

(e) ASIC is satisfied that the extension of the disqualification period is justified.

A person who is subject to a disqualification extension order by ASIC under the proposed s 206F(1A) would have the right to appeal to the Administrative Appeals Tribunal for an order to vary or set aside the extension order, as per the usual appeal process for s 206F orders.

Recommendation 18: Increase the penalties for managing companies while disqualified

- The penalties for managing companies while disqualified under the provisions of Part 2D.6 of the *Corporations Act* that do not require a judicial determination of wrongdoing (e.g. ss 206B(3)–(4), 206F, 206D) should be increased to a fine of up to

[306] If the penalties for an offence under s 206A of the *Corporations Act* were increased as proposed, those convicted of the offence would be subject to a five year automatic disqualification period under s 206B because the offence would be punishable by more than 12 months imprisonment. ASIC would need to take this into account in determining whether it is justified to extend a person's disqualification period under the proposed new s 206F(1A).

[307] The existing 206F(1A) would then become 206F(1B).

100 penalty units or imprisonment for up to two years, or both.

- The penalties for managing companies while disqualified under the provisions of Part 2D.6 of the *Corporations Act* that require a judicial determination of wrongdoing (e.g. ss 206B(1), 206C, 206E) should be increased to a fine of up to 4,500 penalty units or imprisonment for up to five years, or both.
- Section 206F of the *Corporations Act* should be amended to give ASIC the power to extend a disqualification period by up to 10 years if a person manages corporations while disqualified from managing corporations under Part 2D.6 of the *Corporations Act* and the extension is justified.

2.3 Check ABN applicants against ASIC disqualification and restriction registers

The implementation of restricted directorships and restricted companies has the capacity to solve two problems for the ATO. One problem is the inability of the ATO to deny an Australian Business Number ('ABN') to a company. The other is the inability to effectively enforce the requirement that companies likely to default on future tax obligations pay a security bond.

The ATO does have the capacity to deny the granting of an ABN to individuals where they do not believe the individual is carrying on an enterprise, but currently, the ATO does not have the ability to deny an ABN to a registered company.[308] In other words, even if the ATO has grave suspicions about the individuals controlling a company, it must still grant that company an ABN. This is the case whether those individuals are running one or 100 companies, or whether they have a lengthy history of harmful phoenix activity.

The second problem – the security bond issue - is more complicated. Tax laws introduced in 2010 enable the Commissioner of Taxation to obtain security from a taxpayer for any existing or future tax liability,[309] including PAYG(W) and the superannuation guarantee charge,[310] if the Commissioner considers that the taxpayer intends to carry on an enterprise for a limited time only, or if it is otherwise appropriate.[311] Various types of security are provided for,

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308 See Australian Business Register, *ABN Entitlement* <https://abr.gov.au/For-Business,-Super-funds---Charities/Applying-for-an-ABN/ABN-entitlement/>.

309 *Taxation Administration Act* sch 1 sub-div 255-D, inserted by *Tax Laws Amendment (Transfer of Provisions) Act 2010* (Cth) ('*Tax Laws Amendment (Transfer of Provisions) Act*') sch 1 item 9. Prior to this amendment, s 213 of the *Income Tax Assessment Act 1936* (Cth) ('*Income Tax Assessment Act 1936*') allowed the Commissioner to ask for a security bond or deposit for income tax liabilities. Sub-div 255-D expanded on this existing power in a number of important respects: see Morag Donaldson, *Tax Laws Amendment (Transfer of Provisions) Bill 2010*, Bills Digest No 153 of 2009-10, 26 May 2010.

310 *Taxation Administration Act* sch 1 s 250-10(2).

311 Ibid sch 1 s 255-100 (1).

including payments of money and other securities.[312] Failure to pay the security, following receipt of a written notice from the Commissioner, [313] is an offence, punishable by a fine.[314]

However, the punishment is relatively modest, at 100 penalty units for an individual (currently $18,000) and 500 penalty units for a company (currently $90,000).[315] The difficulty with any penalty levied on companies in the phoenix context is that the very act of phoenixing – closing one company down and opening another – has the happy side effect (for the company's directors) of avoiding payment of the penalty, the security bond and the taxes that the ATO was trying to protect in the first place. Prior to the company closing down, it continues to trade, accruing tax debts right up until the time the ATO's penalty action goes to court. This might suggest that the law should be reformed to require the company to cease trading immediately upon failure to pay the security bond. However, we reject this idea because it would adversely affect the company's employees, customers and suppliers.

Another response could be to tighten the security bond mechanism so that there is a meaningful penalty imposed on the directors and managers of companies who cause the company's failure and non-payment of the security bond and penalty, and who then liquidate the company. But this has the potential to catch those 'innocent' individuals in charge of a shaky company that lacks the ability to pay the security bond or the penalty. The proper action for such people is to liquidate the company promptly. They face personal liability for insolvent trading otherwise. Liquidating the company cannot therefore also be the trigger for a personal punishment.

A lateral approach here is not to target the failing company but rather the creation of a new company. However, this presents the difficulty of being able to differentiate those who ought to get another chance to run a company and those who should not. This is the perennial problem with phoenix activity – the need for a mechanism to allow the 'right' people to try again while preventing the 'wrong' people from doing so. Because the ATO is such a significant creditor affected by harmful phoenix activity, it should have the power to grant ABNs conditionally – for example, by requiring payment of a bond or the provision of security over an asset owned by the restricted director. The restricted directorship and restricted company process would assist the ATO with that filtering. To implement this new mechanism, the ATO would need to consult ASIC's register of restricted directors and restricted companies.

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312 Ibid sch 1 s 255-100(2).
313 Ibid sch 1 s 255-105.
314 Ibid sch 1 s 255-110.
315 The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

The ATO should go one step further and check whether any of the associates of the company applying for the ABN are disqualified from managing corporations. The ABN application requires 'associate details',[316] including the name, date of birth, position held and tax file number ('TFN') of all Australian resident directors. At present, the ATO does consult ASIC regarding ABN applications but only to check the validity of the ACN. It does not check whether any associates of the company are disqualified directors.

Recommendation 19: Check ABN applicants against restricted & disqualified registers

- On receipt of an application for an ABN, the ATO should check with ASIC whether the company's associates are restricted directors or disqualified directors.
- The ATO should report to ASIC where it has uncovered disqualified directors attempting to be involved in the management of a company so that ASIC may commence a prosecution under s 206A.
- The ATO should have the power to refuse to grant an ABN to a company which lists a disqualified director as an associate.
- In granting an ABN to a company which lists a restricted director as an associate, the ATO should be given the discretion to:
    - grant the ABN to the restricted company conditional upon the payment of a bond or the provision of security over an asset owned by the restricted director; or
    - grant the ABN unconditionally.

2.4 Introduce independent valuations of asset transfers between related parties

In our opinion, harmful phoenix activity could be significantly disrupted by independent valuations of asset transfers between related parties.

When a company collapses, it is possible that the only buyer for its assets is a new company run by the failed company's former directors and officers. The new company may be able to buy the assets as a whole, rather than them being sold off piecemeal for a lesser value, and may be willing to pay something for retained goodwill which they alone can exploit. Against this optimistic scenario are set the deliberate acts of phoenix activity to shed Oldco's debts and continue the business through a new company. It is important to allow for the possibility of the former, whilst mitigating against the latter.

[316] Australian Business Register, *Associate Details* <https://abr.gov.au/For-Business,-Super-funds---Charities/Applying-for-an-ABN/What-you-need-for-your-ABN-application/Associates-details/>.

The taint of a related party asset transfer could be managed through an independent valuation of the worth of the company's assets, which could be obtained before the sale is concluded. Independent valuations for 'connected party sales' were considered by the United Kingdom's Graham Review of pre-packaged administrations,[317] known as 'pre-packs'. Pre-packs, discussed further below at [5.2.1], involve the sale of the business prior to the company entering formal external administration. The Graham Review was particularly concerned with connected party sales, as almost two-thirds of the 499 companies it examined involved such a sale.[318]

In terms of requiring an independent valuation, Graham recommended a voluntary approach.[319] Where no independent review of the connected party sale had been obtained, the pre-pack documentation would simply record the fact and creditors could make an appropriate response later in exercising rights in relation to the pre-pack. The Graham Review recommended the formation of 'pre-pack pools', independent bodies of experienced business people to give an opinion on whether it is not unreasonable to proceed with a connected party sale as part of a pre-pack process.[320] Because of the pre-pack context – a quick pre-insolvency sale of the business to try to preserve as much of the business's value as possible – the pool would have 48 hours to give its opinion.[321] Graham also recommended that connected parties should be able to approach the pool at other times to obtain an opinion.[322]

While we have concerns about the idea of pre-packs for Australia, at [5.2.1], we do think the idea of an independent valuation for related party sales would be useful in the Australian phoenix activity context. The 48-hour turnaround would not be necessary here, nor do we believe the voluntary approach is a valuable one. Rather, we think that a rebuttable presumption has many advantages. In action by ASIC or the liquidator for breach of directors' duty, there would be a rebuttable presumption that a related party transaction is not arm's length. The presumption could be rebutted by an independent valuation or such other evidence as the court considers appropriate. It is then open to Oldco's directors to decide whether there is a risk of the transfer being challenged by an external administrator or ASIC

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317 Theresa Graham CBE, *Graham Review into Pre-pack Administration: Report to The Rt Hon Vince Cable MP* (June 2014) ('*Graham Review*') [7.45]–[7.82]. The *Graham Review* was commissioned by Vince Cable, the Secretary of State for Business Innovation and Skills, as part of the UK Government's wider 'Transparency and Trust' agenda: see UK Insolvency Service, *Graham Review into Pre-pack Administration* (16 June 2014) <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>.

318 *Graham Review*, ibid, [7.50].

319 Ibid [8.3].

320 Ibid [9.8].

321 Pre Pack Pool, 'UK Businesses Set for more Confidence in Pre-packs as Reform Begins' (Press Release, 2 November 2015) 2.

322 *Graham Review*, above n 317, [9.4].

and thus whether they should spend the time and money on an independent valuation. To avoid unfairly harsh operation, there would need to be limits on the time period over which the presumption would operate. Twelve months prior to insolvency seems reasonable.

What constitutes an independent valuation would need to be carefully considered. Options here include valuation by an accredited valuer holding professional indemnity insurance, mandatory public auctions of assets over a certain value, or a more holistic approval of a transaction as a whole by a panel of experts, approved by ASIC. ASIC has indicated to us that there are now compromised 'independent' valuers who are willing to make false certifications for a fee. One way to overcome this would be for ASIC to assign a 'first cab off the rank' valuer to the task.

The rebuttable presumption should only operate for transfers of assets over a particular value. The sum of $5,000 is used in Chapter 2E of the *Corporations Act* to exempt small related party transactions from requiring member approval.[323] One difficulty with setting a value is that it may encourage the undervaluing of assets. This would not only benefit the recipient, Newco, but it would also avoid the operation of the rebuttable presumption. The alternative would be to set no limit, but this might lead small business people to allege it is an overly burdensome provision, in effect requiring an independent valuation for the most trivial transfer. We favour having a value limit. To tackle avoidance behaviours – for example, multiple transfers below the limit – the value limit could be expressed as 'asset transfer or transfers totalling $5,000 over a 12 month period'. Outside of the proposed independent valuation presumption regime remains the power of both liquidators[324] and ASIC[325] to attack uncommercial transactions should the $5,000 limit be abused.

'Related party' would not have the meaning assigned under s 228 of the *Corporations Act* for the purpose of related party transactions by public companies. In the definition of a related party, this curious provision includes a company run by a spouse's parents but does not include siblings or close associates. A starting point for developing a more useful definition is the 'connected party' definition outlined in the Graham Review.[326]

i) a connected party is
   - a director, shadow director or company officer of the insolvent company;
   - an associate of a director, shadow director or company officer of the insolvent company; and
   - an associate of the insolvent … who becomes:

[323] *Corporations Act* s 213(1); *Corporations Regulations 2001* (Cth) reg 2E.1.01.
[324] *Corporations Act* s 588FB.
[325] *Corporations Act* s 588G(1A) item 7.
[326] *Graham Review*, above n 317, [9.5].

- a director, shadow director, company officer of the new company;
- exercises control over the new company as defined in section 435(10) …
- an associate of a director, shadow director or company officer of the new company; and
- an associate of the new company.

ii) "Associate" means any person set out in section 435 of the 1986 Act with the exclusion of subsection (4) which relates to employees (who are not directors or shadow directors).

'Associate' is widely defined in s 435 of the *Insolvency Act 1986* (UK) to include a wide range of relatives, business partners, and joint controllers of businesses.

Recommendation 20: Introduce independent valuations of related party transfers

- In an action by ASIC or the liquidator for breach of directors' duty, there should be a rebuttable presumption that a related party transaction is not arm's length.
- The presumption would be rebutted by an independent valuation or such other evidence as the court considers appropriate.
- The operation of the presumption would be subject to a 12 month limit prior to insolvency and a $5,000 asset value limit to avoid the provision being too onerous on business.
- Definitions should be inserted for 'independent valuation' and 'related party'.

2.5 Limit the backdating of directorships

We oppose ASIC allowing the lodging of backdated 'notification of change to directors' forms beyond three months. Anecdotally, we have heard that enforcement actions may be frustrated by a debt-laden company lodging a backdated 'notification of change to directors' form[327] and appointing a 'man of straw' prior to a regulator taking action. An example of this was presented by the 7.30 Report,[328] where the homeless client of an accounting firm was registered as a director of companies with outstanding ATO debts. He was then issued DPNs by the ATO. In some instances, the directorship was backdated up to five years.[329] Alarmingly, the alleged perpetrator of this fraud had 'form'.[330]

[327] ASIC, above n 70.
[328] See ABC, above n 39.
[329] Dan Oakes and Sam Clark, *Melbourne Man Linked to Alleged Tax Evasion Scheme Previously Accused of Ripping Off Investors* (17 October 2016) ABC News <http://www.abc.net.au/news/2016-10-17/unwitting-clients-signed-up-as-directors-to-failing-businesses/7939622>.
[330] See Mark Russell, 'Former Footballers Claim $4 Million Fraud', *The Age* (Melbourne), 4 March 2012; Mark Russell, 'Retirees Sue Bankrupt Adviser for $1.2m', *The Age* (Melbourne), 22 August 2010; Mark

At present, the change of directorship form is costless to lodge within one month, with a $75 fee for between one and three months late, and a $312 fee for more than three months late. For some wrongdoers, it is worth paying $312 to avoid a DPN or liability as a director under the *Corporations Act*.

We cannot see the justification for allowing backdated 'notification of change to directors' forms beyond three months. This is sufficient time to allow the paperwork to catch up with the reality. The departing director remains liable as a director until they are replaced, which should provide an excellent incentive to complete the form in a timely manner.

Recommendation 21: Limit the backdating of directorships

- Changes to directorships should only be able to be backdated up to three months.

2.6 Expand the Director Penalty Notice regime

Directors are under an obligation to 'cause the company to comply with its obligation' to pay certain tax liabilities such as Pay-As-You-Go Withholding (PAYG(W)) tax.[331] This obligation continues until the company has paid that tax or is wound up or placed into voluntary administration ('VA'). Directors become liable for a penalty through the issuance of a DPN if they do not cause the company to pay those liabilities by the due date. Some very limited defences are available to directors.[332]

In 2010, the director penalty notice provisions were moved and amended in a minor way.[333] In 2012, the DPN regime was further amended to extend it to unpaid superannuation guarantee charge ('SGC') liabilities and to limit the circumstances in which directors can discharge a DPN by placing their company into VA or liquidation.[334] While employees are still credited with the PAYG(W) tax credits whether they are remitted to the ATO by the company or not, directors have lost the right to claim their own PAYG(W) tax credits since 2012 due to PAYG(W) non-compliance tax.[335]

Russell, '"Toothless" Watchdog Under Fire', *The Sydney Morning Herald* (Sydney), 29 August 2010; Oakes and Clark, above n 41.

331 *Taxation Administration Act* sch 1 s 269-15.

332 Ibid sch 1 s 269-35. Defences include taking all reasonable steps to ensure either payment or external administration, or 'because of illness or for some other good reason, it would have been unreasonable to expect you to take part, and you did not take part, in the management of the company' at the time of the obligation to remit the taxes.

333 *Tax Laws Amendment (Transfer of Provisions) Act*, sch 1 items 2 (repealing *Income Tax Assessment Act 1936* pt VI), 10 (inserting *Taxation Administration Act* sch 1 div 269).

334 *Taxation Administration Act* sch 1 div 269, as amended by *Tax Laws Amendment (2012 Measures No. 2) Act 2012* (Cth) sch 1 ('*Tax Laws Amendment (2012 Measures No. 2) Act*').

335 *Taxation Administration Act* sch 1 sub-div 18-D, inserted by *Tax Laws Amendment (2012 Measures No. 2) Act* sch 1 item 14; *Pay As You Go Withholding Non-compliance Tax Act 2012* (Cth).

In 2009 the Treasury Proposals Paper suggested that GST be included in the DPN regime. [336] One of the concerns is that GST is not payable until the sale of the finished item has taken place but that input tax credits can be claimed prior to that time. This is a particular concern in the building and construction industry. According to the November 2013 minutes of the Interagency Phoenix Forum,

- There is a GST focus on the building and construction industry that do not pay the GST until a sale has occurred and yet are legally entitled to claim input tax credits during the project's roll-out.
- Current watch list consists of 2169 groups with 30,000 entities (most in NSW).
- Estimate is that the ATO has written off $10.8 billion over the last 10 years.[337]

The difficulty in expanding the DPN regime to include company taxes such as GST is that it is perceived to remove, for 'honest' directors, the protection of operating a business via a limited liability company as a separate legal entity. This was the sort of response that met the 2011 attempts to automate aspects of the DPN regime.[338] The 2012 Act which replaced the 2011 bill did not adopt automation, instead retaining the ATO's obligation to issue a notice.

In reality, the DPN regime does not undermine the advantages of running a business through a company. First, limited liability is a concept protecting shareholders from the debts of the company, and the DPN regime, however narrow or broad, does not impose liability on shareholders. Second, director liability for unremitted company taxes can be avoided by the directors placing the insolvent company promptly into liquidation or voluntary administration, where the directors have properly reported what is owing. This is surely not unreasonable. Directors properly performing their duties under the *Corporations Act* must monitor the financial situation of their company as part of their duty of care. In addition, they risk insolvent trading liability under s 588G(2) of that Act if they fail to prevent the company incurring debts when there are reasonable grounds to suspect insolvency. The company's ability to pay its debts should always be uppermost in the minds of directors.

Extending the DPN regime to GST was opposed by the Inspector General of Taxation in 2015.[339] However, the IGT appears to have misunderstood the consequences of including the GST in the DPN regime. It stated:

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336 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [4.2.2].

337 See ATO, *Inter-Agency Phoenix Forum Minutes* (12 November 2013) item 7 <https://www.ato.gov.au/General/The-fight-against-tax-crime/In-detail/Inter-Agency-Phoenix-Forum/Inter-Agency-Phoenix-Forum-minutes---12-November-2013/>.

338 House of Representatives Standing Committee on Economics, Parliament of Australia, *Advisory Report on the Tax Laws Amendment (2011 Measures No. 8) Bill and the Pay As You Go Withholding Non-compliance Tax Bill 2011* (2011) [1.60], [2.78].

339 *IGT Debt Collection Report*, above n 231, [4.51]–[4.53].

> 4.52 The above idea was not adopted by the then Government. Whilst stakeholders acknowledge the benefit of DPNs to secure superannuation and PAYG Withholding which properly belongs to employees and support its use in this respect, it is uncertain whether the broader public would consider GST to be of the same importance as employee entitlements. *Furthermore, if the DPN regime was extended to GST, it would effectively elevate the then Government's standing against employees and other creditors.*[340] Such an outcome is contrary to the Government['s] adoption of the recommendations of the 1988 Harmer Report which supported the removal of Commonwealth priority in relation to tax for reasons including:
>
> - the ATO may allow taxation debts to accumulate without prejudicing its position and this may disadvantage other unsecured creditors who may not know that tax is owed;
> - the ATO has no incentive to recover payment in the normal commercial manner;
> - the ATO should obtain no greater priority than any other person claiming in relation to debts misappropriated by the insolvent company; and
> - there would be a reduction in litigation.
>
> 4.53 Accordingly, the IGT is of the view that DPNs should not be expanded to GST at the present time.[341]

Including the GST in the DPN does *not* elevate the government's standing against employees and other creditors. Employees remain priority creditors in a liquidation, with payment of their entitlements *from the company's assets* ranking behind secured creditors and the costs of the administration. The DPN regime imposes liability for unremitted PAYG and superannuation *on the directors* – an additional and separate source of payment. The most that adding GST to the DPN regime would do is to increase the amount payable *by the director* and if the director has insufficient personal assets to cover the amount of the DPN, there may not be full recovery by the ATO. This could impact on the recovery of superannuation which directly benefits employees. This issue could be addressed by creating a priority arrangement within the DPN regime, such that unremitted PAYG and superannuation are recovered first, and GST second, in the event of an insufficiency of director funds. For these reasons, we disagree with the IGT's position and we support the

340 Emphasis added.
341 *IGT Debt Collection Report*, above n 231, [4.52]–[4.53].

extension of the DPN regime to GST.[342] The reporting of liabilities with respect to PAYG(W) will be impacted by the Single Touch Payroll mechanism, discussed in [2.7].

We also support the introduction of a DPN provision for state tax liabilities. In New South Wales, s 47B of the *Taxation Administration Act 1996* (NSW) allows the Office of State Revenue to issue a compliance notice, like a DPN, to a director in respect of unremitted payroll taxes. As with a DPN, liability is avoided where the company is placed into VA or liquidation within 21 days. We encourage other state legislatures to adopt such a provision.

Nonetheless, it is worthwhile pausing here to consider what the ATO really wants in terms of directors who repeatedly phoenix their companies. Phoenix activity, by its very nature, lends itself to the avoidance of a DPN liability. The director might seek to deliberately liquidate the company to avoid employee entitlements or trade debts, and a happy consequence (for the director) is that tax liabilities are also avoided. In our discussions with various people from the ATO, the complexity of their dilemma became apparent. How can the ATO detect and discourage phoenix operators who fail to remit company taxes but who quickly liquidate company after company, thereby avoiding a DPN?

We believe the solution lies in the various general measures recommended for the benefit of all creditors. For example, the removal of fictitious directors via a DIN: [1.1.1]; improved visibility of directors' prior corporate histories at the time of corporate collapse: [1.2.2]; and at the time of the incorporation of new companies: [1.1.2]; as well as 'restricted' directorships: [2.1], which may discourage people from engaging in harmful phoenix activity without the ATO having to take any steps at all. In addition, better data collection by ASIC which is passed on to the ATO: [1.3.2] and [1.6], allows the ATO to intervene earlier and more effectively. Data about unmet tax liabilities for previous companies with which a restricted director was connected, made available to credit reporting agencies: [1.5.3], is likely to result in that director finding it harder to finance later ventures. In effect, this becomes an informal market-based type of disqualification.

Put simply, our recommendations to protect creditors generally should be viewed as very useful to the ATO too.

Recommendation 22: Expand the Director Penalty Notice (DPN) regime

- The DPN regime in the *Taxation Administration Act* should be expanded to include GST liabilities.

[342] The Senate Committee inquiry into insolvency in the building and construction industry also recommended that consideration be given to ensuring that the DPN regime covers GST liabilities: *SERC Construction Insolvency Report*, above n 14, recommendation 19, [7.47].

- An equivalent to the DPN should be introduced in state taxation legislation across Australia.
- The DPN should be recognised as constituting only part of a wider suite of measures beneficial to the ATO to tackle harmful phoenix activity.

2.7 Require payment of tax and super via Single Touch Payroll

The original 'single touch payroll' proposal – reporting and paying PAYG(W) taxes and superannuation contributions at the same time the employee is paid – has the capacity to reduce much of the incentive to engage in harmful phoenix activity. For serial inept entrepreneurs, it stops them unwittingly getting in over their heads, time and time again. For deliberate phoenixers, it takes away much of the benefit of phoenix activity.

In terms of unremitted taxes and superannuation, the government appears to have acknowledged the advantages of prevention with the introduction of 'single touch payroll' ('STP').[343] Initially this was mooted as a mechanism whereby employers would pay their employees *and* related PAYG(W) remittances and superannuation contributions in a 'single touch'. Harmful phoenix activity is attractive because the non-payment of taxes and superannuation are two of the major losses it causes through the liquidation of the failed employer.

However, the government has amended the STP proposal so that now it will only cover the *reporting* of tax and superannuation obligations. This alteration was in response to concerns from business about the 'cash flow' implications[344] of having to pay the taxes at an earlier time than is presently the case. In other words, while wages are generally paid fortnightly, PAYG(W) and superannuation are usually only remitted monthly or quarterly depending on the size of the business and the terms of the super fund trust deed. The objection raised shows the extent to which businesses rely on employee-related sums – 'their money' until it is legally payable – to finance their businesses, and also shows the hesitation of the government to interfere with this practice.

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343 See The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Streamlining Business Reporting with Single Touch Payroll' (Media Release, 21 December 2015).

344 'Nobody disputes that PAYG tax and super is an employee entitlement and must be paid, the sooner the better. But this is an area where a desirable policy objective needs to take into account the fact that many SMEs struggle with cash flow … It takes more than 50 days on average for small business accounts to be paid and many are in a weak negotiation position with key clients': Accountants Daily, *CAANZ Latest to Criticise ATO's Single Touch Payroll* <http://www.accountantsdaily.com.au/latest-news/17-news/8069-caanz-latest-to-criticise-ato-s-single-touch-payroll>, quoting Michael Croker, head of tax at Chartered Accountants Australia and New Zealand. See also Michael Croker, Submission to ATO, *Single Touch Payroll Discussion Paper* (12 March 2015) 10–13.

The STP *as a reporting mechanism only* undermines the effectiveness of 'lockdown' DPNs. This requires some background explanation. As noted in [2.6], the DPN regime is designed to provide an incentive for directors to ensure their companies pay their employees' PAYG(W) and superannuation amounts, failing which they themselves will be liable for these payments. Without more, this would be a draconian arrangement, so the DPN regime allows directors to avoid this personal liability if they either cause the company to pay the amount or place their company into external administration within 21 days. However, this 'escape route' is only available to the directors *if they report* what is owing to the ATO. This is designed to give the ATO the information it needs to send out the DPN. The intended result is either that the tax and super obligations are paid, or the company is placed in external administration and is no longer accruing tax liabilities.

It was recognised that in many instances, amounts were neither paid nor reported, so in 2012, laws amended the DPN regime to create 'lockdown' DPNs.[345] As a result, if the amount owing is not reported, the director loses their right to use the external administration 'escape route'. Provided the ATO becomes aware of the amount owing from some means *other than* reporting by the employer and then sends the DPN, the directors must pay the company's PAYG(W) and superannuation obligations and cannot avoid these by placing the company into external administration.

If the single touch payroll proposal is utilised only to report amounts owing, the result will be that 'lockdown' DPNs will only be effective for those who fail to use STP. The onus will be back on the ATO to send DPNs to all those directors who have reported their company's tax and super obligations but not paid them. Once these directors receive their DPNs, they have 21 days to shed this liability by placing the company into external administration. The 'lockdown' mechanism, which has been used effectively by the ATO,[346] is likely to be less utilised. This puts the onus back on the ATO to manually process DPN notices for all unremitted taxes. In 2012, automatic DPNs were mooted but rejected.[347]

Recommendation 23: Require payment of tax and super via Single Touch Payroll

- 'Single touch payroll' which requires both reporting and payment of tax and superannuation obligations should be gradually introduced.
- If single touch payroll is not expanded as recommended, the proposal for automated DPNs should be re-considered.

[345] See Helen Anderson, 'The Proposed Deterrence of Phoenix Activity – An Opportunity Lost?' (2012) 34 *Sydney Law Review* 411, 416–18.

[346] See Anderson et al, *Quantifying Phoenix Activity Report*, above n 9, 79.

[347] Tax Laws Amendment (2011 Measures No 8) Bill 2011 (Cth) sch 3; Kai Swoboda and Xenia Stathopoulos, *Tax Laws Amendment (2011 Measures No 8) Bill 2011 [and] Pay As You Go Withholding Non-compliance Tax Bill 2011*, Bills Digest No 78 of 2011-12, 21 November 2011, 11.

- The ATO should ensure that DPNs are sent to all directors of companies which fail to remit PAYG(W) taxes and superannuation payments, to ensure that either the amounts are paid or these companies are promptly placed into external administration to avoid further losses accruing.

3 PUNISH AND DETER HARMFUL PHOENIX ACTIVITY

The previous two chapters considered ways to make harmful phoenix activity more visible and less easy. Inevitably, some people will persist in this behaviour because they expect the profit gained to exceed the likelihood and consequences of being caught. This chapter examines ways to punish wrongdoing more effectively, to make harmful phoenix activity less profitable, and to extend the reach of enforcement actions to those who facilitate harmful phoenix activity.

In order to make phoenix activity illegal, laws must proscribe the improper behaviour – for example, the undervalued transfer of assets – rather than the fact that this improper behaviour occurred during a business 'rescue'. Actual illegality in the phoenix context only occurs where the directors have, for example, breached their duties as directors to the failed company or have committed fraud.[348] However, discovering these breaches of duty or fraud – and all the evidence that a court will require for a successful action – is not easy, and this hinders enforcement.

Even if detection of illegality were easy, the fact remains that the problems for creditors, revenue authorities and competitors are caused not just by those breaking the law but also by those who are causing repeated losses through multiple failed attempts at running businesses. While a number of regulators have measures at their disposal that address failure to pay debts[349] without requiring proof of breach of duty or fraud, even this 'legal but problematic' behaviour by those we have termed 'serial inept entrepreneurs' may be hard to uncover and then act upon.

A recent Productivity Commission report commented that 'rather than crafting new offences, improvements in the detection and enforcement of existing laws are likely to be the best option for creating a genuine disincentive for directors contemplating phoenix action.'[350] While we do not support the creation of new offences,[351] we propose a number of reforms that make it easier for regulators and others to bring enforcement action against those involved in harmful phoenix activity.

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348 Relevant laws include: *Corporations Act* ss 180–184, 588G (directors' and officers' duties), 590, 592, 596 (corporate frauds); *Taxation Administration Act* ss 8K, 8L, 8T and 8U (tax frauds); *Criminal Code Act 1995* (Cth) sch 1 ('*Criminal Code*') s 134.2 (theft offences). See also below n 388.

349 These include Director Penalty Notices under *Taxation Administration Act* sch 1 div 269, discussed above at [2.6]. Accessory liability under *Fair Work Act* s 550 requires knowing involvement rather than proof of breach of duty or fraud.

350 Productivity Commission, *Business Set-up Report*, above n 16, 425.

351 For further discussion, see: [5.1.1], [5.1.5].

To achieve the objectives of punishing wrongdoing more effectively, making it less profitable, and extending the reach of enforcement actions to those who facilitate it, the following improvements need to be made in enforcement:

- The role of liquidators in the enforcement process needs to be clarified and they need to be provided with adequate funding to perform that role.
- Enforcement action in the phoenix context needs to be prioritised.
- There must be better reporting of enforcement to aid general deterrence.
- The law should be altered or augmented to:
    - Expand or elucidate existing laws that are ineffective or unclear.
    - Increase the penalties for breaches.
    - Remove the benefit of harmful phoenix activity through orders of compensation in favour of creditors.
    - Expressly address the role of advisors.

3.1 Clarify the role of liquidators in the enforcement process and provide adequate funding

Where suspected illegal behaviour may have occurred in the lead up to the insolvency, ASIC has enforcement powers against the directors personally. ASIC's mandate is to act in the public interest.[352] In exercising its powers, ASIC seeks specific deterrence to secure the future compliance of the directors, as well as general deterrence to warn the regulated population. ASIC's enforcement role can be contrasted with the recovery role of the liquidator. Liquidators act primarily in the furtherance of private interests, being those of the insolvent company's creditors. Nonetheless, this dichotomy is not so clear-cut. Liquidators play an important quasi-regulatory role in assisting ASIC to investigate wrongdoing at the time of the external administration of a failed company. They also bring asset recovery actions in court, which, despite being 'private' proceedings, have a deterrent effect that benefits the public. We recommend that the role of liquidators in the public enforcement process be clarified and adequate funding be provided to perform that role.

Upon appointment, external administrators become responsible for the affairs of the failed employer company.[353] As noted at [1.2], liquidators pay outstanding liabilities from the company's remaining assets according to specified priorities in the *Corporations Act*.[354] Voluntary administrators[355] and receivers[356] have their own specified powers and

[352] Section 1(2)(a) of the *ASIC Act* provides that '[i]n performing its functions and exercising its powers, ASIC must strive to: maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy.' See also *ASIC Act* ss 1(2)(b)–(g).

[353] *Corporations Act* ss 477 (liquidators), 437A (administrators).

[354] Ibid s 556.

[355] See ibid pt 5.3A.

responsibilities.[357] Each of these external administrators must also lodge reports with ASIC indicating whether they suspect misconduct by the company's directors.[358] The responsibilities of the three kinds of external administrator differ. Because the period of voluntary administration is short and the administrator's main task is to attempt to save the company or execute a deed of company arrangement,[359] little investigation can be done. Receivers are appointed to protect the interests of a secured creditor. As a result, liquidators carry out the majority of investigations during external administration.

While ASIC does engage in some preventative visits to companies,[360] external administrators are the main source of 'on the ground' investigation looking into the circumstances of failed companies. ASIC rightly points out that '[e]xternal administrators are the front-line investigators of insolvent corporations.'[361] Their work contributes towards '(a) maintaining the integrity of the marketplace; and (b) promoting investor and consumer confidence.'[362] The investigation and detection roles of liquidators have also been judicially acknowledged.[363] The information obtained by external administrators is used by ASIC to select cases to pursue further. ASIC's 2014-15 Annual Report noted that

> ASIC allocates its resources to achieve the greatest market impact. With less resources, we are generally unable to conduct random sampling-based surveillance. Instead, we focus on strategically important gatekeepers to direct surveillance resources towards the risks that pose the greatest threat.[364]

In its latest annual report, ASIC notes that '11,494 companies [were] identified for the potential to conduct illegal phoenix activity.' ASIC allocated six 'surveillance resources' to 'a small sample of entities in high-risk industries' and 'reactive surveillances and reviews to target risks or concerns.'[365] The report estimated that six 'surveillance resources' would also be allocated in 2016-17. In our view, this demonstrates ASIC's heavy reliance on external administrators as phoenix detectives.

While all external administrator costs are priorities in a liquidation, this does not necessarily ensure that liquidators will be paid for their work, and this impacts upon the amount of

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356 See ibid pt 5.2.

357 See ASIC, *Information Sheet 54: Receivership – A Guide for Creditors* (December 2008); ASIC, *Information Sheet 74: Voluntary Administration – A Guide for Creditors* (December 2008).

358 Ibid ss 533 (liquidators), 422 (receivers), 438D (administrators).

359 See ibid pt 5.3A, s 435A.

360 See, eg, FWO, 'Spot Checks for 50 Brisbane Employers' (Media Release, 26 May 2016).

361 *ASIC Regulatory Guide 16*, above n 89, [16.4].

362 Ibid [16.5].

363 See, eg, *Australian Securities and Investments Commission v Midland Hwy Pty Ltd (administrators appointed); in the matter of Midland Hwy Pty Ltd (administrators appointed)* [2015] FCA 1360, [78]–[79].

364 ASIC, above n 141, 36.

365 ASIC, above n 11, 22.

investigation that can be undertaken. Since illegal phoenix activity may be done for the purpose of ensuring that creditors are not paid what they are entitled, phoenixed companies may have few or no assets. Illegal phoenixing may therefore escape detection 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. There is no express duty imposed on liquidators to investigate where the liquidator will not be paid. On the contrary, the *Corporations Act* makes it clear that liquidators are *not* obliged to carry out work for which they will not be paid, beyond fulfilling their duty to report.[366]

Nonetheless, the government maintains that liquidators must play a public role:

> 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.[367]

Thus, liquidators are an integral part of the public enforcement process. Their investigations which lead to AAF funding are expressly stated to be undertaken to enable ASIC to bring enforcement action.[368] In addition, liquidators are able to bring enforcement actions themselves and – given the scarcity of enforcement actions by ASIC in the phoenix context [3.2] – their actions are undoubtedly the principal source of deterrence in relation to phoenix activity.

The government must deal with the issue of funding for liquidators if it expects them to be 'gatekeepers' supplementing ASIC's six 'surveillance resources' in the phoenix context. If liquidators are to be charged with the primary responsibility for investigating wrongdoing – in addition to performing a vital enforcement role in the form of asset recovery actions that benefit both creditors and the broader public through general deterrence – these investigatory responsibilities should be expressly stated in the *Corporations Act* and adequate funding needs to be provided. While the introduction of liquidator funding from the Department of Employment[369] is a welcome development, this is likely to be limited to circumstances where

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366 See *Corporations Act* s 545.

367 Treasury (Cth), *Proposed Industry Funding Model for the Australian Securities and Investments Commission: Consultation Paper* (28 August 2015) 49. Note that it is appropriate that ASIC continue its oversight of liquidators to ensure that they are discharging their responsibilities in accordance with the law and professional standards. Liquidator scrutiny by ASIC will be assisted by the provisions inserted into the *Corporations Act* by the *Insolvency Law Reform Act 2016* (Cth): see, eg, *Insolvency Law Reform Act* sch 2 ss 40-5 ('Registered liquidator to remedy failure to lodge documents or give information or documents'), 40-100 ('Notice by industry bodies of possible grounds for disciplinary action').

368 See *ASIC Regulatory Guide 109*, above n 74, [109.5]–[109.8], [109.67], [109.96].

369 See Department of Employment (Cth), above n 138; see also Helen Anderson, 'FEG, Moral Hazard and the Innovation Agenda' (2016) 28(2) *Australian Restructuring Insolvency and Turnaround Association Journal* 28.

there are large amounts of Fair Entitlements Guarantee advances.[370] There is currently inadequate funding for liquidators to investigate smaller insolvencies, which is precisely where harmful phoenix activity is likely to be most prevalent.

Recommendation 24: Clarify the enforcement role of liquidators and increase funding

- The government needs to address the issue of adequate funding for liquidators to ensure that they can discharge their statutory duty to report properly.
- If liquidators are to be charged with the primary responsibility for investigating wrongdoing – in addition to their important enforcement role in bringing asset recovery actions – these investigatory responsibilities should be expressly stated in the *Corporations Act* and adequate funding should be provided.

3.2 Prioritise public enforcement action in the phoenix context

Enforcement action is by no means automatic once an allegation of wrongdoing comes to a regulator. Upon receiving intelligence about a possible breach, ASIC[371] conducts a detailed assessment of a matter when determining whether to take an enforcement action,[372] then decides whether to hold a formal investigation, following which further policy considerations come into play.[373] The ATO and the FWO also have their own litigation and debt collection policies which constrain the circumstances under which enforcement action will be launched.[374] Even where wrongdoing is referred by one regulator to another for possible enforcement action, it may not be actioned. Matters can fall between the cracks.

General deterrence is not only a function of the availability of severe sanctions (see our discussion of the size of penalties at [3.4.2]) and enforcement actions being made known to the public (see our discussion of enforcement reporting at [3.3]). It is also impacted by the perceived certainty (or lack thereof) of detection and prosecution, and, following prosecution,

370 See, eg, the funding from both the Assetless Administration Fund and the Fair Entitlements Guarantee Recovery Program in the Bruck Textiles administration: Peter Gosnell, *Bruck Scrutiny Attracts FEG and ASIC Funding* (12 May 2016) Syndey Insolvency News <http://sydneyinsolvencynews.com/bruck-scrutiny-attracts-feg-and-asic-funding/>.

371 See ASIC, *Information Sheet 151: ASIC's Approach to Enforcement* (September 2013) 2.

372 'What is the extent of harm or loss? What are the benefits of pursuing the misconduct, relative to the expense? How do other issues, like the type and seriousness of the misconduct and the evidence available, affect the matter? Is an alternative course of action available?': ibid.

373 'What is the nature and seriousness of the misconduct? What was the post-misconduct behaviour of the offender? What is the strength of the case? What impact will the remedy have on: the person or entity; the regulated population; the public? Are there any mitigating factors?': ibid.

374 See FWO, *Litigation* <https://www.fairwork.gov.au/about-us/our-role/enforcing-the-legislation/litigation>; ATO, *Practice Statement Law Administration* <http://law.ato.gov.au/atolaw/view.htm?Docid=PSR/PS201114/NAT/ATO/00001>.

the likelihood that the available sanctions will in fact be imposed.[375] Where detection or prosecution are unlikely, the availability of a severe sanction may fail to deter misconduct. It is therefore critical that enforcement actions not only result in substantial sanctions that are reported to the public, but that they are carried out with sufficient frequency to create the perception that there is a real chance of being prosecuted.

We have concerns about the frequency with which enforcement action is taken in the context of harmful phoenix activity. Despite there already being a multitude of ways that regulators can take enforcement action against the types of illegal behaviour that can occur during phoenix activity,[376] estimates have placed the economic cost of phoenix activity in the billions of dollars per annum, suggesting that this harmful behaviour continues to be prevalent.[377] While it is not possible to identify precisely how much phoenix activity involves illegality or how much enforcement takes place against illegal phoenix activity because of a lack of available data,[378] in our view it is likely that rates of enforcement against harmful phoenix activity are low relative to how frequently it occurs.

For example, since civil penalties were introduced for breaches of directors' duties in 1993, there has only been one civil penalty application brought by ASIC for breach of directors' duties in the context of phoenix activity[379] and the only orders imposed were disqualification orders, despite the availability of both pecuniary penalties and compensation orders.[380] To put this in perspective, in 2015-16 alone, external administrators reported that they suspected 424 criminal breaches of the directors' duties[381] and 1,125 civil breaches of the s 182 duty.[382] While insolvency-related wrongdoing is a broader category than phoenix activity and these are only suspected rather than proven breaches, the overwhelming disparity in the figures suggests that enforcement of directors' duties is not having the desired deterrent effect.

Part of the explanation for the low rate of directors' duties enforcement in the phoenix context may be that less severe enforcement options, such as administrative disqualification

375 See John Howe and Tess Hardy, 'Business Responses to Fair Work Ombudsman Compliance Activities' (Research Report, Centre for Employment and Labour Relations Law, The University of Melbourne, January 2017) 3–6.

376 See Anderson et al, *Defining and Profiling Phoenix Activity Report*, above n 1, 10–13, 16–17, 24–25, 28.

377 PricewaterhouseCoopers, above n 8, estimating the economic cost of phoenix activity at between $1.78 and $3.19 billion per year: at ii–iii. The ATO has estimated the cost to the Australian economy of phoenix activity and related practices at between $1 and $2.4 billion per year: ATO, above n 8, 16.

378 See Anderson et al, *Quantifying Phoenix Activity Report*, above n 9.

379 *ASIC v Somerville* [2009] NSWSC 934; *ASIC v Somerville (No 2)* [2009] NSWSC 998.

380 Ibid.

381 This figure includes 150 suspected breaches of the directors' duty to prevent insolvent trading under s 588G(3) of the *Corporations Act*.

382 *ASIC Report 507*, above n 157, 37–8. In addition, external administrators reported that they suspected 3,636 breaches of s 180, 1,954 breaches of s 181, 329 breaches of s 183, and 5,736 breaches of ss 588G(1)–(2): at 38.

under s 206F of the Corporations Act (presently capped at a maximum of five years), are used in the place of court proceedings and more serious penalties. An example is Mr Geaney, disqualified for three years by ASIC due to the failure of 15 companies. Some had provocative names such as Donuts and Beers Pty Ltd, EBA This Pty Ltd, Paperless Pty Ltd, Golfing Holidays Abroad Pty Ltd, and Lawful Alternatives Pty Ltd. ASIC's media release stated that:

> While there were 15 failed companies, enquiries by ASIC found that these companies related to three businesses and that 13 of the companies, that were all wound up at the same time, largely conducted the same business through the various forms in an attempt to avoid paying payroll tax.
>
> ASIC found that the majority of the companies failed owing money to employees for superannuation in addition to significant sums to the Australian Taxation Office (ATO) and the State Revenue Office. ASIC found that in relation to the majority of the companies, Mr Geaney failed to ensure that the companies maintained proper books and records or that he failed to provide records to the liquidator of the companies.[383]

It seems likely that this sort of egregious conduct would involve breaches of a number of the directors' duties, yet to our knowledge the only sanction imposed on Mr Geaney was a three-year disqualification order. This is potentially a missed opportunity to impose much more significant sanctions, such as a substantial financial penalty, longer disqualification period, or even a custodial sentence if the requisite *mens rea* elements were present and able to be substantiated.

The case involving the director of the Ksubi fashion companies is another example of what seems to be a missed opportunity to bring court proceedings for breaches of directors' duties:

> Collaroy director, Mark Frederic Byers, has been banned by ASIC from managing companies for the maximum of five years for his conduct in the management of four failed companies. …
>
> As a result of information contained in reports provided by the liquidators of the failed companies, ASIC was concerned Mr Byers had failed to prevent insolvent trading by two of the companies and failed to ensure they paid their taxes, failed to discharge his duties as a director and had engaged in illegal 'phoenix activity' – an activity which involves transferring the assets of an indebted company into a new company, while leaving the initial company with insufficient assets to pay creditors.

[383] ASIC, 'ASIC Disqualifies Four Directors' (Media Release, 08-81, 18 April 2008).

> ASIC Commissioner, Greg Tanzer, said 'ASIC will ensure that directors who are involved in illegal phoenix activity and fail to appropriately discharge their duties will be removed from the management of companies.'[384]

ASIC's media releases only provide limited information[385] and there may have been evidentiary, strategic or practical reasons why directors' duties proceedings were not brought in the Geaney and Byers cases. However, based on the information available, these examples certainly raise a question about whether better use could be made of court proceedings for breaches of directors' duties in the phoenix context.

The directors' duties are not the only under-utilised laws in the phoenix context. From 2000, uncommercial transactions became actionable as insolvent trading.[386] An undervalued transfer of assets – very typical during phoenix activity – is an uncommercial transaction.[387] By deeming the transaction to be the incurring of a debt, the 2000 amendment enables ASIC to issue civil penalty proceedings alleging a contravention of the insolvent trading provisions against directors. However, we could not locate any instances of ASIC using this mechanism to punish harmful phoenix operators between 2004 and 2014.

To achieve general deterrence of harmful phoenix activity, regulators must examine and address the apparent scarcity of enforcement actions taken against phoenix operators.[388]

Recommendation 25: Prioritise enforcement action in the phoenix context

- Regulators should prioritise taking enforcement action against persons who engage in

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384 ASIC, 'ASIC Bans Director of Failed Companies for Maximum Five Year Period' (Media Release, 16-295MR, 6 September 2016).

385 See [1.4.2] for further discussion of the lack of publicly available information about ASIC's decisions under s 206F.

386 *Corporations Act* s 588G(1A), inserted by *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth) sch 1 item 3. See Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000 (Cth) [10]: 'The inclusion of uncommercial transactions in section 588G(1A) has implications for the protection of employee entitlements, the prosecution of directors involved in "phoenix" activity and recovery actions by liquidators for the benefit of creditors generally.'

387 *Corporations Act* s 588FB.

388 In addition to civil actions, there are several criminal offences that do not appear to have been used in the phoenix context, such as s 596AB of the *Corporations Act* (see [3.4.1]) and s 5 of the *Crimes (Taxation Offences) Act 1980* (Cth) (see [5.1.5]). However, this may be partly due to the difficulty of proving *mens rea* elements to the 'beyond reasonable doubt' standard of proof. Other relevant offences include: *Corporations Act* ss 590 (Failure to disclose property of the company), 596 (Improper disposition or fraudulent concealment of property); *Taxation Administration Act* ss 8C (Failure to comply with requirements under taxation law), 8D (Failure to answer questions when attending before the Commissioner), 8K (False or misleading statements), 8N (Recklessly making false or misleading statements), 8L (Incorrectly keeping records), 8Q (Recklessly incorrectly keeping records), 8T (Incorrectly keeping records with intention of deceiving or misleading), 8U (Falsifying or concealing identity with intention of deceiving or misleading), 8Y (Liability of officers of corporations); *Criminal Code* ss 134.1 (Obtaining property by deception), 134.2 (Obtaining a financial advantage by deception), 135.4 (Conspiracy to defraud).

unlawful conduct in the course of phoenix activity so as to reduce the prevalence and economic cost of harmful phoenix activity.

3.3 Improve public reporting of enforcement activity

Full and accurate reporting of enforcement actions available against, and taken against, those engaging in harmful phoenix activity is useful for three reasons.

The first is general deterrence. The regulated population must have knowledge of the available sanctions.[389] This is important for those individuals who are naturally inclined not to comply with the law because it impacts on their perception of the cost of non-compliance. However, awareness of the available sanctions also impacts on those members of the regulated community who are naturally inclined to be law abiding. Such members of the regulated population may be motivated to comply with the law or regulatory requirements by normative factors that include their 'internalized values and moral reasoning'[390] and their belief about the legitimacy and importance of the legal requirement in question.[391] A knowledge that the legislature has deemed certain behavior to be illegal and has attached sanctions to it increases such people's commitment to compliance.

It is particularly important in areas such as phoenix activity, where the delineation of lawful and unlawful behaviour can be unclear, that sanctions are attached to the illegal form of this activity, and the regulated community is aware of the availability of those sanctions. It is pleasing to see ASIC bring a criminal action relating to phoenix activity and explain publicly what behaviour is being prosecuted:

> Ms Timko, a former sole director of A Twisted Little Company Pty Ltd (ATLC), operated a number of Noodle Box franchises in Northern Tasmania. Following an ASIC investigation, it is alleged that Ms Timko:
>
> - entered into a Bill of Sale to sell the plant and equipment of ATLC for $30,000 to another company;
> - had authorised the plant and equipment to be transferred to the other company without receiving the $30,000;
> - placed ATLC in liquidation soon after the plant and equipment was transferred to that other company; and

[389] This depends, of course, on a conscious decision to engage in improper conduct, made by rational decision makers: John Byam, 'The Economic Inefficiency of Corporate Criminal Liability' (1982) 73 *Journal of Criminal Law and Criminology* 582, 587.

[390] Yuval Feldman and Doron Teichman, 'Are All Legal Probabilities Created Equal?' (2009) 84 *New York University Law Review* 980, 993.

[391] Soren Winter and Peter May, 'Motivation for Compliance with Environmental Regulations' (2001) 20 *Journal of Policy Analysis and Management* 675, 677.

- reassigned a number of leases entered into by ATLC to operate Noodle Box stores to the other company, which was contrary to a franchise agreement entered into between ATLC and the franchisor, Noodle Box Franchising Australia Pty Ltd.

The effect of the transfer of the plant and equipment and reassignment of the leases meant that creditors of ATLC may have been denied access to its assets.[392]

Unfortunately, the actual breach provision was not reported, with the press release simply referring to 'two counts of fraudulent conduct under the *Corporations Act 2001*.'[393] In another example involving typical phoenix circumstances, ASIC's press release made it clear that the criminal action was for breach of directors' duties.[394]

The second justification for wider reporting of actions against harmful phoenix activity is specific deterrence, as the reporting exposes those who engage in it to reputational risk. This aspect of enforcement reporting, sometimes colloquially referred to as 'naming and shaming', increases the chances of deterring the phoenixer from engaging in further unlawful activity because they fear that others will avoid doing business with them.[395]

The third benefit of enforcement reporting is that it enables quantification of enforcement, which is important for assessing the effectiveness of law enforcement: [1.6].[396] For example, if the evidence indicates that an increasing rate of enforcement of a law correlates to a decreasing rate of misconduct targeted by that law, this may suggest, depending on what other variables are at play, that the current laws and enforcement practices are proving effective. If the evidence indicates an increasing rate of misconduct despite an increasing rate of enforcement, this might indicate that the current laws or enforcement practices require reform, or that an entirely new approach is needed. Without systematic reporting of enforcement, it is very difficult to know whether or not the current approach is working.

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392 ASIC, 'Former Noodle Box Franchisee Allegedly Engaged in Illegal Phoenix Activity' (Media Release, 16-449MR, 19 December 2016).

393 Ibid.

394 ASIC, 'Former Director Charged with Breaching Director Duties' (Media Release, 16-452MR, 20 December 2016).

395 See also Christine Parker and Vibeke Lehmann Nielsen, 'How Much Does It Hurt? How Australian Businesses Think about the Costs and Gains of Compliance and Noncompliance with the Trade Practices Act' (2008) 32 *Melbourne University Law Review* 554; Vibeke Lehmann Nielsen and Christine Parker, 'To What Extent Do Third Parties Influence Business Compliance?' (2008) 35 *Journal of Law in Society* 309, at 329; Christine Parker and Vibeke Lehmann Nielsen, 'What Do Australian Businesses Really Think of the ACCC, and Does It Matter?' (2007) 35 *Federal Law Review* 187; Feldman and Teichman, above n 390, 993; John Braithwaite and Toni Makkai, 'Testing an Expected Utility Model of Corporate Deterrence' (1991) 25 *Law and Society Review* 7, 8.

396 See also Anderson et al, *Quantifying Phoenix Activity Report*, above n 9.

Because there are no laws that explicitly and specifically target harmful phoenix activity,[397] to achieve both general and specific deterrence, there needs to be reporting of the patchwork of laws of more general application that can be used against those who engage in it. This has two dimensions. First, the actual actions need to be reported in a systematic way, for example, via a media release or publicly available website.[398] Second, the phoenix context needs to be highlighted. At the very least, this should be done for the three most common forms of enforcement – director disqualification under s 206F,[399] summary prosecutions for failure to provide books and records,[400] and ATO director penalty notices to enforce remittance of PAYG(W) taxes and superannuation contributions.[401]

The number of s 206F orders is usually reported in ASIC's annual reports but only about half of these are also reported in ASIC's media releases. These orders are also listed in ASIC's 'Banned and Disqualified Persons Dataset'.[402] To improve its reporting, the government should look at the UK Insolvency Service's 'Enforcement Outcomes Monthly data tables', which provide an excellent model for reporting statistical data on disqualification orders.[403] These tables present the following data from 2009–10 onward: the number of disqualifications; the number of disqualifications made pursuant to each legislative section; the average length of the disqualifications; and the number of disqualifications by length band (i.e. 2 to 5 years, 5 to 10 years, 10 to 15 years). They also include clear and detailed notes on the data sources and methodology, which is essential for being able to meaningfully interpret the data.

The number of summary prosecutions is usually reported in ASIC and CDPP annual reports.[404] Until March 2011, ASIC's summary prosecutions were also reported in its 'Prosecution Reports', which included the name and address of the defendant, the offence provision, and the outcome of the prosecution (e.g. a fine or good behaviour bond, among other outcomes).[405] These prosecution reports appear to have been replaced with enforcement

397 See Anderson et al, *Defining and Profiling Phoenix Activity Report*, above n 1. We discuss the issue of a phoenix offence at [5.1.1].

398 The 'Media outcomes' section of the FWO's annual report provides a good example of the range of avenues that are available to regulators to publicise their activities: see FWO, *Annual Report 2015–16* (28 September 2016) 14.

399 See [2.2.1], [1.4.2].

400 See above nn 87–88 and accompanying text. For an explanation of ASIC's summary prosecution power, see above n 303 and accompanying text.

401 These average over 4,000 per year: see Anderson et al, *Quantifying Phoenix Activity Report*, above n 9, 79.

402 See Australian Government, above n 192. See [1.4.2] for further discussion.

403 See UK Insolvency Service, above n 279.

404 See ASIC, *ASIC Annual Reports* <http://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/>; CDPP, *Publications and Policies* <https://www.cdpp.gov.au/publications>.

405 See ASIC, above n 293.

outcome reports.[406] However, this has resulted in much less information being available. Whereas previously it was possible to identify the individual convicted, the offence committed, and the sanction imposed, it is now only possible to identify the number of prosecutions. ASIC should recommence publishing prosecution reports to activate the 'naming and shaming' aspect of these prosecutions. The reputational risk created by better enforcement reporting may in some instances be more of a deterrent than the sanctions themselves. The prosecution reports should also indicate the director's DIN: [1.1.1] and the companies in connection with which the offences occurred.

The ATO does not appear to currently report statistics on DPNs. However, the ATO was able to provide us with statistics on DPNs issued during the years 2010-11 to 2014-15, indicating that the raw data required to collate these statistics is available internally. Given the large volume of notices issued per year – an average of over 4,000 notices across a five year period – it would be excessively burdensome to require the ATO to systematically report the details of every notice issued. Instead, the aggregate statistics on notices issued, as provided to us by the ATO, should be published in its annual reports or elsewhere on its website annually and a media release should be issued that draws attention to and explains the DPN statistics. In addition, the ATO should report the identities of directors who fail to comply with DPNs,[407] including their DINs and the companies in connection with which the noncompliance occurred. This would help to deter directors from failing to comply with DPNs.

The preceding discussion covers the first dimension of improving the reporting of phoenix-related enforcement activity, which is that enforcement actions need to be reported in a systematic way.[408] The second dimension, as noted above, is that the reports need to expressly state whether the enforcement action is taken in response to, or in the context of, phoenix activity. Because the laws that can be used to target harmful phoenix activity, such as directors' duties and disqualification orders, can be used to target various other forms of misconduct, it is critical to highlight when enforcement actions *are* related to phoenix

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406 The first of these reports was ASIC, *Report 281: ASIC Enforcement Outcomes – July to December 2011* (March 2012): see ASIC, *ASIC Enforcement Outcomes* <http://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-enforcement-outcomes/>. These reports indicate the number of criminal actions against directors of small businesses, which we suspect are mostly summary prosecutions carried out by ASIC. However, the lack of any explanatory notes means that it is unclear exactly what types of actions are included within this category: see Gilligan et al, 'Regulating by Numbers: The Trend Towards Increasing Empiricism in Enforcement Reporting by Financial Regulators' (2015) 9 *Law and Financial Markets Review* 260, 273.

407 To avoid doubt, this does not include directors who avoid the DPN by promptly putting the company into voluntary administration under the *Corporations Act* or into liquidation, as this is permitted under the DPN regime: see *Taxation Administration Act* sch 1 ss 269-1, 269-5.

408 ASIC notes that it is continuing to 'seek ways to improve public reporting on … activities and enforcement outcomes': ASIC, *Report 511: Regulator Performance Framework – ASIC Self-assessment 2015–16* (December 2016) [199].

activity. The absence of a specific 'phoenix law' should not be seen as an impediment to the reporting of phoenix-related enforcement activity. Just as police flag matters as related to Family and Domestic Violence (FDV), where the data is then aggregated by the Australian Bureau of Statistics in relation to a range of general criminal offences,[409] enforcement actions taken in relation to phoenix activity could be flagged and systematically aggregated and reported.

Recommendation 26: Improve public reporting of enforcement activity

- To improve the reporting of phoenix-related enforcement activity, regulators should:
  - using the UK Insolvency Service model, provide meaningful information about enforcement via media releases or websites to enhance specific deterrence and general deterrence (all regulators);
  - recommence publication of ASIC summary prosecution reports and add categories for the DIN and companies in connection with which the offence was committed (ASIC only);
  - report ATO aggregate statistics on DPNs annually and issue a media release announcing and explaining the statistics (ATO only);
  - report the identity of directors who fail to comply with DPNs, including their DIN and companies in connection with which the failure occurred (ATO only); and
  - collate and report data about enforcement in the phoenix context to enable reliable assessment of the efficacy of existing and newly introduced laws (all regulators).

3.4 Amend key legislation to bolster enforcement against harmful phoenix operators

In this part of the report we recommend a number of legislative amendments designed to punish harmful phoenix operators, compensate their victims, remove the financial incentives to engage in phoenix activity, and ensure that accessories do not escape liability.

[409] See Australian Bureau of Statistics, *Victims of Family and Domestic Violence – Related Offences* (19 December 2016) <http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/4510.0~2015~Main%20Features~Experimental%20Family%20and%20Domestic%20Violence%20Statistics~6>.

3.4.1 Expand section 596AB of the Corporations Act

Amendment of the never-used criminal provisions to protect employee entitlements is well overdue. The *Corporations Law Amendment (Employee Entitlements) Act 2000* inserted Part 5.8A into the *Corporations Act*.[410] The relevant provision is s 596AB(1), which states that

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

There are two possible outcomes from breach of this section. The first is a criminal prosecution attracting a maximum punishment of 1,000 penalty units (currently $180,000)[411] or imprisonment for 10 years or both.[412] The second is civil action by a liquidator under s 596AC for the recovery of the entitlements.

According to the Act's Explanatory Memorandum,[413] the object of s 596AB was 'to deter the misuse of company structures and of other schemes to avoid the payment of amounts to employees that they are entitled to prove for on liquidation of their employer'.[414] Yet the section has never been used in a criminal action, most likely because of the section's requirement of intention, proved subjectively to the criminal standard of 'beyond reasonable doubt'.[415] The 2004 Stocktake Report recommended that it be reviewed and

> in light of the evidence suggesting that some corporations deliberately structure their business to avoid paying their full entitlements to employees and more generally unsecured creditors, the Committee recommends that the review look beyond the effectiveness of the Act and consider, and offer advice on, possible reforms that would deter this type of behaviour. [416]

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410 See above n 386 and accompanying text for further discussion of this legislative reform.

411 The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

412 *Corporations Act* sch 3 item 145.

413 Explanatory Memorandum, Corporations Law Amendment (Employee Entitlements) Bill 2000 (Cth).

414 Ibid [18].

415 We were also unable to find any reference to liquidators bringing civil actions against directors under s 596AC of the *Corporations Act*, although the section may be used informally as a device to induce directors to contribute some additional money towards the liquidation. Even the liquidator recovery provision, while a civil action, depends upon a contravention of s 596AB, which is predicated on subjective proof of improper intent.

416 Parliamentary Joint Committee on Corporations and Financial Services, above n 22, ch 8, recommendation 43.

This recommendation was not acted upon. ASIC has not brought any cases under s 596AB in relation to deliberate arrangements to deprive employees of their entitlements, which may be due to the section's inherent difficulties and the policy ASIC adopts in selecting matters for enforcement, which requires it to consider, among other factors, the strength of the case and alternative courses of action.[417] ASIC,[418] the FWO[419] and the 2015 SERC Construction Insolvency Report[420] all support reform to s 596AB to make this section effective.

There are three possible enforcement actions available for a breach of the directors' duty to prevent insolvent trading:[421] a civil penalty application,[422] a criminal prosecution where the director acted dishonestly,[423] and a civil recovery action by the liquidator.[424] This pattern should be replicated in relation to s 596AB. To do so would require the insertion of a civil penalty version of the breach provision while keeping the criminal provision with the required intention element, as follows.

Section 596AB should provide:

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

(1A) A person must not enter into a relevant agreement or a transaction if a reasonable person would not have entered into the relevant agreement or the transaction unless they had the intention of, or intentions that include the intention of:
   (a) preventing the recovery of the entitlements of employees of a company; or
   (b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.

Note: This subsection is a civil penalty provision (see subsection 1317E(1)).

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417 See ASIC, above nn 371–373.

418 See ASIC, Submission No 20 to Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, February 2015, [143]; ASIC, above n 52, 16–18.

419 FWO, above n 286, 6.

420 *SERC Construction Insolvency Report*, above n 14, recommendation 20, [7.56].

421 *Corporations Act* s 588G.

422 Ibid s 588G(2).

423 Ibid s 588G(3). Note that the court, as a consequence of a criminal conviction, can also order the director to compensate the company: s 588K.

424 Ibid s 588M.

Recommendation 27: Expand s 596AB of the Corporations Act

- Section 596AB should be amended to include a civil penalty provision, proved via an objective test, in addition to the criminal offence.

3.4.2 Increase maximum penalties under the Corporations Act and Fair Work Act

The economic premise that underpins deterrence theory is that many members of the regulated community can be expected to internalise the cost of non-compliance. By setting the cost of non-compliance at a sufficiently high level, would-be non-compliers will be encouraged to comply with the law.[425] It is important that penalties are set at an appropriate level because weak penalties that cost less than the advantage to be gained by the infraction are likely to be ineffective and considered by some to be 'the cost of doing business'. In *ASIC v Vizard*[426] Finklestein J said

> My real concerns here are with punishment for retributive purposes and general deterrence, but principally the latter.
>
> Indeed general deterrence is of primary importance in cases of this kind. A message must be sent to the business community that for white collar crime "the game is not worth the candle", to use the language of a Canadian judge, McDermid JA, in *R v Jaasma* (1976) 1 AR 553, 555.

In general, we do not favour increasing penalties that are imposed on *corporations* because the heavier the penalty on the company, the more incentive the directors have to place the company into liquidation to avoid its payment. Penalties imposed on corporations in these circumstance only reduce the amount of money left to pay creditors. However, we do support an increase in penalties that can be imposed on the directors of companies that engage in illegal phoenix activity. The Cole Royal Commission in 2003 also recommended increasing the maximum penalties in the *Corporations Act* for offences that may be associated with illegal phoenix activity.[427]

3.4.2.1 Breaches of directors' duties

Illegal phoenix activity necessarily involves breaches of directors' duties under the *Corporations Act.* As noted above at [3.2], effective enforcement of directors' duties is central to combatting illegal phoenix activity, and the penalty must provide a sufficient

[425] See Christine Parker and Vibeke Lehmann Nielsen, 'What Do Australian Businesses Really Think of the ACCC, and Does it Matter?' (2007) 35 *Federal Law Review* 187, 192–4.
[426] [2005] FCA 1037, [47]–[48].
[427] *Cole Royal Commission Report*, above n 23, recommendation 108.

deterrent. To achieve this, the statutory maximum civil pecuniary penalties and criminal fines must be increased substantially to enhance the deterrent effect of the directors' duties regime.

Where civil penalty proceedings are issued, ASIC can seek a pecuniary penalty of up to $200,000 per contravention, disqualification of the director or officer, and a compensation order.[428] While the disqualification order under this regime is not limited and some permanent disqualifications have been imposed[429] (although notably not in the phoenix context, as discussed at [2.2.1]), the maximum amount of the pecuniary penalty has not increased since these provisions were introduced in 1993. Moreover, the maximum civil pecuniary penalty is lower than the legislative maximum penalties in other areas of Australian law[430] and significantly lower than those in other major common law jurisdictions.[431] There should be an increase in the maximum pecuniary penalty under the civil penalty regime to $500,000, which is equivalent to the maximum civil penalty for individuals contravening the cartel conduct provisions and other restrictive trade practices under the *Competition and Consumer Act 2010* (Cth).

The statutory maximum criminal fine for breaches of directors' duties is set at 2,000 penalty units (currently $360,000).[432] This is less than half the maximum fine available for other similarly serious criminal offences under the *Corporations Act*. A range of offences attract a maximum criminal fine of the greater of 4,500 penalty units (currently $810,000),[433] or three times the benefit gained, or both: market manipulation; false trading and market rigging; dissemination of information about illegal transactions; false or misleading statements; inducing persons to deal; dishonest conduct; and insider trading.[434] With regard to the importance of ensuring consistency of penalties for similarly serious offences, the Attorney-General's Department's *Guide to Framing Commonwealth Offences* provides:

> A penalty should be consistent with penalties for existing offences of a similar kind or of a similar seriousness. This should include a consideration of existing offences within the legislative scheme and other comparable offences in Commonwealth legislation such as the Criminal Code.[435]

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428 *Corporations Act* ss 1317G, 206C, 1317H.

429 See, eg, *ASIC v Elm Financial Services Pty Ltd* (2005) 55 ACSR 544, *ASIC v White* (2006) 58 ACSR 261, *ASIC v Maxwell* (2006) 24 ACLC 1.

430 ASIC, *Report 387: Penalties for Corporate Wrongdoing* (March 2014) [73]–[74].

431 Ibid [9], [64], [82]–[84]; ASIC, Submission No 49 to Senate Economics References Committee, *Inquiry into Penalties for White Collar Crime*, April 2016, [25]–[27].

432 *Corporations Act* sch 3 items 30, 50, 138; *Crimes Act 1914* (Cth) s 4AA. The penalty unit will be increased from $180 to $210 on 1 July 2017: Crimes Amendment (Penalty Unit) Bill 2017 (Cth).

433 The penalty unit will be increased from $180 to $210 on 1 July 2017: ibid.

434 *Corporations Act* ss 1041A, 1041B(1), 1041C(1), 1041D, 1041E(1), 1041F(1), 1041G(1), 1043A(1), 1043A(2), sch 3 item 310; *Crimes Act 1914* (Cth) s 4AA.

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

Accordingly, the statutory maximum criminal fine for breaches of directors' duties should be increased to 4,500 penalty units, to achieve a greater level of consistency with other similarly serious offences under the *Corporations Act*.

Another widely adopted approach to setting administrative, civil and criminal financial penalties in general[436] is to set the penalty as the greater of a fixed number or a multiple of the gain derived from the unlawful conduct. As noted above, this approach has already been adopted in the *Corporations Act* for certain offences.[437] The fact that other common law jurisdictions tend to either have unlimited pecuniary penalties or the option of a multiple of the benefit gained was examined by ASIC in its submission to the *Inquiry into Penalties for White Collar Crime*.[438] The rationale behind this approach is to ensure that the sanction outweighs the benefit of engaging in the unlawful conduct.

This deserves further consideration. On the one hand, allowing the courts to order a pecuniary penalty that is a multiple of the benefit gained could result in a situation where the profits are effectively stripped from the defendant twice, once via a revamped s 1317H (which we recommend below at [3.4.3]) and once via a pecuniary penalty set as a multiple of the benefit gained. While it is critical that illegal phoenix operators are punished and the severity of the sanctions significantly outweighs the benefit of the unlawful conduct, it is equally important that the severity of the sanctions is not disproportionate to the unlawful conduct and that the punishment 'fits the crime'.

On the issue of proportionality, it is important to note that the recommended increases are to the statutory *maximum* civil penalty and criminal fine, which are not representative of the typical penalties and fines imposed by the judiciary in practice.[439] The judiciary exercises its discretion to impose a penalty or fine that is appropriate having regard to all of the circumstances of the particular case, which guards against disproportionate outcomes. A

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436 For example, this approach is adopted by Singapore, New Zealand, the United States and Hong Kong in relation to civil or administrative pecuniary penalties for certain types of wrongdoing. It is also adopted by Australia and Canada in relation to criminal fines for certain offences. It is also worth noting that the United Kingdom and Hong Kong have unlimited civil or administrative pecuniary penalties for certain wrongs, while the United Kingdom and Singapore have unlimited criminal fines for certain offences: see ASIC, Submission No 49 to Senate Economics References Committee, *Inquiry into Penalties for White Collar Crime*, April 2016, [22]–[27].

437 See above n 434 and accompanying text.

438 Ibid [25]–[27].

439 In the ten-year period from 2005 to 2014, the median civil pecuniary penalty imposed for breaches of directors' duties was $50,000, which is just 25% of the maximum penalty of $200,000. During this same period, the courts only imposed four criminal fines for criminal breaches of directors' duties of $4,000, $10,000, $10,000 and $75,000, the highest of which is only 21% of the current maximum fine of $360,000: see Jasper Hedges, Helen Bird, George Gilligan, Andrew Godwin and Ian Ramsay, 'An Empirical Analysis of Public Enforcement of Directors' Duties in Australia: Preliminary Findings' (Working Paper No 105, Centre for International Finance and Regulation, March 2016) 25–7.

substantial statutory maximum is important because it enables the court to impose a proportionate sanction in response to more egregious instances of wrongdoing.[440]

Recommendation 28: Increase the maximum penalties for breaches of directors' duties

- The maximum civil pecuniary penalty for an individual under s 1317G of the *Corporations Act* should be increased to $500,000.
- The maximum criminal fine for offences against ss 184, 588G(3) and 209(3) under Schedule 3 of the *Corporations Act* should be increased to 4,500 penalty units.
- Consideration should be given to introducing penalties that are a multiple of the benefit gained, to properly undermine the incentive to engage in illegal phoenix activity.

3.4.2.2 Fair Work Act individual liability

Under the *Fair Work Act*, an individual is only subject to a fine one fifth the size of that of a company for a civil remedy breach.[441] This makes it beneficial for directors of employer companies to liquidate that entity and face the penalty as an accessory to the company's non-payment as a necessary expense in getting rid of those employee entitlements.[442] The added advantage here is that unremitted taxes are also shed because the act of liquidating the company removes the ATO's means of imposing personal liability via a director penalty notice.[443]

Courts should have the ability to order the same fine against an individual as a company in specified circumstances, assessed objectively. The amount of the additional penalty should be within the judgment of the court, subject to a maximum level specified in the Act. A significant fine on the director as an accessory to the company's breach could make them think twice about doing this, although no fine would be as effective as an order of compensation against the accessory for the amount of the unpaid entitlements: [3.4.4].[444]

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440 For further discussion on increasing the penalties for breaches of directors' duties, see Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, 'Illegal Phoenix Activity: Is a "Phoenix Prohibition" the Solution?' (2017) *Company and Securities Law Journal* (forthcoming).

441 *Fair Work Act* s 546(2).

442 However, note the decision in *Fair Work Ombudsman v Konsulteq Pty Ltd* [2015] FCCA 182, where a director who incorporated two companies as 'alter egos … as a shield for his own conduct' was ordered to pay the penalties imposed upon the companies in the event that they defaulted within the time period specified for them to pay: [33], order 9.

443 *Taxation Administration Act* sch 1 s 269-15(2)(c). See [2.6] for further discussion of director penalty notices.

444 The *Fair Work Act* allows the court to order that a penalty be paid to the employee rather than into consolidated revenue: s 545(3).

The following example shows two small penalties imposed on individuals where the gains to the business from their conduct were significantly greater than those penalties and where it appears that the business has been phoenixed to avoid the company bearing a heavy penalty. According to a Fair Work Ombudsman press release in October 2016,

> A businessman with a history of misconduct and his former human resources manager have been penalised for what a Judge has labelled "appalling" and "objectionable" conduct affecting vulnerable workers.
>
> Travice Blom - who formerly operated recruitment and labour-hire company Oz Staff Career Services Pty Ltd - has been penalised $14,960 for unlawfully deducting $130,000 from the wages of 102 Melbourne cleaners and falsifying pay records to hide the practice.
>
> In addition, former Oz Staff Career Services human resources manager Alex Linossi, has been penalised $9920 for his part in facilitating some of the unlawful deductions and the false records. …
>
> Penalties could not be obtained against Oz Staff Career Services because the company was placed into liquidation last year. …
>
> Judge Burchardt also noted that Blom seemingly continues to operate the business that was formerly Oz Staff Career Services through a successor company, Oz Staff Holdings Pty Ltd, and is the sole director of seven other companies.
>
> "Something remarkably similar to the activities of (Oz Staff Career Services) is now carried on by another business of which (Blom) is the sole director," Judge Burchardt said. [445]

In our opinion, s 546 of the *Fair Work Act* should be amended to include the following provision:

> (2A) Notwithstanding subsection (2), the court may order that an individual pay the penalty otherwise applicable to a body corporate, where:
>
> (a) the company of which the individual is a director has entered liquidation if a reasonable person would not have placed the company into liquidation unless they had the purpose of, or purposes that include the purpose of, avoiding an order by the court that the company pay entitlements payable under this Act or avoiding the payment of any penalty imposed on the company for a failure to pay those entitlements; or
>
> (b) where the individual owned the whole or substantially the whole of the shares in the company; and
>
> in either case, it is just and equitable.

[445] FWO, 'Penalties for "Appalling" Conduct in Unlawfully Deducting $130,000 from Cleaners' Wages' (Media Release, 24 October 2016).

Recommendation 29: Increase the penalties for Fair Work Act individual liability

- Section 546 of the *Fair Work Act* should be amended to allow the court to impose the same penalty on an individual as it would on a company where the company has been placed into liquidation to avoid a penalty and other specified circumstances exist.

3.4.3 Remove the benefit of harmful phoenix activity

Recovering the property that the phoenix operators transferred to Newco is beneficial because it removes the financial incentive to engage in phoenix activity and contributes towards the payment of Oldco's creditors.

In Australia, there is a range of provisions applicable in the phoenix context that allow the recovery of property dispersed around the time of insolvency. Part 5.7B of the *Corporations Act* empowers the liquidator to recover preference payments[446] in a variety of situations including uncommercial transactions,[447] and unreasonable director-related transactions.[448] The latter can benefit the director directly or indirectly.[449] State property statutes allow the voidance of fraudulent property transactions.[450] There is also scope within the inherent jurisdiction of the court to make an interlocutory freezing order preventing the transfer of asset from Oldco to Newco. This was exemplified in *International Skin Care Suppliers v Whyte*[451] where Newco's director was the son of Oldco's director and Newco was occupying the premises of Oldco under Oldco's lease. Potentially, Newco could be deprived of its benefit through the use of either accessory liability under s 79 of the *Corporations Act* or through the 'knowing receipt' first limb of *Barnes v Addy*.[452]

However, there needs to be a more targeted approach to removing the benefit of harmful phoenix activity from Newco. Section 1317H(1) allows the court to order a person in contravention of a civil penalty provision to compensate the company for damage resulting

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446 The court may order, *inter alia*, payment of an amount of money or a transfer of property: *Corporations Act* s 588FF(1)(a)–(b).

447 Ibid s 588FB.

448 Ibid s 588FDA.

449 See *Vasudevan v Becon Constructions (Australia) Pty Ltd* [2014] VSCA 14.

450 See, eg, *Property Law Act 1958* (Vic) s 172: '(1) Save as provided in this section, every alienation of property made, whether before or after the commencement of this Act, with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced.' See also *Conveyancing Act 1919* (NSW) s 37A; *Property Law Act 1974* (Qld) s 228; *Property Law Act 1969* (WA) s 89; *Law of Property Act 1936* (SA) s 86; *Conveyancing and Law of Property Act 1884* (Tas) s 40; *Law of Property Act 2000* (NT) s 208; *Civil Law (Property) Act 2006* (ACT) s 239.

451 [2011] NSWSC 46. See also Janna Robertson and Kieran Ryan 'Phoenix Activity: An Alternative to Section 588FE' (2013) 25(3) *Australian Insolvency Journal* 12.

452 See *Barnes v Addy* (1874) LR 9 Ch App 244; *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89; R. P. Austin and I. M. Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (Online edition, LexisNexis Butterworths, 2016) [16.190].

from the contravention. Section 1317H(2) provides that '[i]n determining the damage suffered by the corporation or scheme for the purposes of making a compensation order, include profits made *by any person* resulting from the contravention or the offence.'[453] This sub-section has been interpreted by the courts to be a standalone 'account of profits' mechanism.[454] That is, it is not necessary to prove *any* loss on the part of the corporation or scheme that has 'suffered the damage' in order to obtain a 'compensation' order under s 1317H; the 'damage' can be *entirely* comprised of profits. So-called 'compensation' orders under s 1317H can therefore be compensation orders, account of profits orders, or a combination of both.

Section 1317H(2) would allow a court to order the director in breach to compensate Oldco for the profits made by Newco from an undervalued transaction. But what it does *not do* is allow the court to order Newco – an entity not in breach of any law – to hand over its gains. Expanding the reach of s 1317H would both facilitate enforcement and provide important signalling benefits. Courts, and those tempted by illegal phoenix activity, would have a clear indication from Parliament that the beneficiary of the breach of duty should be stripped of the gains it has made. This explicit statement overcomes the need for courts to 'piece together' the same outcome which is implicit in s 79 and s 1317H.

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

Compensation orders—corporation/scheme civil penalty provisions

Compensation for damage suffered

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

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

(b) the damage resulted from the contravention.

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

453 Emphasis added.

454 See *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296, [620]–[631]; *V-Flow Pty Ltd v Holyoake Industries (Vic) Pty Limited* (2013) 296 ALR 418, [54]; R. P. Austin and I. M. Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (Online edition, LexisNexis Butterworths, 2016) [3.400.12].

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

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

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

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

(b) the damage resulted from the contravention.

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

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

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

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

(b) the damage resulted from the contravention; and

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

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

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

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

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

Damage includes profits

(2) In determining the damage suffered by a person or scheme for the purposes of making a compensation order, include profits made by any person resulting

from the contravention. A compensation order may be solely comprised of such profits.

Damage to scheme includes diminution of value of scheme property

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

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

Recovery of damage

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

The expanded s 1317H ensures that those engaging in illegal phoenix activity are deprived of the benefits of their behaviour where those benefits are held by Newco, and victims are compensated to the maximum extent possible. This is a critical amendment to directors' duties enforcement, which currently does not provide any clear pathway for recovering the benefits of illegal phoenix activity except from the wrongdoers themselves. As noted above, s 588FB does allow liquidators to recover benefits resulting from uncommercial transactions, but its availability depends upon the transaction occurring during the company's insolvency, which significantly reduces its effectiveness.[455] Likewise, ASIC's ability to bring civil penalty or criminal insolvent trading action in relation to uncommercial transactions via s 588G(1A) is also limited by the requirement of insolvency.[456] Attaching the recovery mechanism to directors' duties rather than uncommercial transactions avoids the requirement of actual insolvency at the time of the transaction. At the same time, the directors' duties provisions provide an important limitation on the reach of the recovery mechanism, ensuring that enforcement action is only taken in cases of wrongdoing and not genuine business rescues.[457]

In addition to amending s 1317H, we recommend that ASIC be given the power to seek disgorgement in civil penalty proceedings. ASIC has been vocal in seeking to undermine financial incentives that encourage wrongdoing. For example, in its submission to the Senate Economics References Committee's white collar crime inquiry, ASIC stated:

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455 *Corporations Act* s 588FE(3), with 'insolvent transaction' defined by s 588FC.

456 *Corporations Act* s 588G(1A) item 7.

457 For further discussion of the proposed amendments to s 1317H of the *Corporations Act*, see Anderson et al, above n 440.

> ‘Disgorgement’ is the removal of financial benefit … that arises from wrongdoing, or the act of paying these monies, on demand or by legal compulsion. For example, any profit made by wrongdoing is ‘disgorged’ from those involved in the wrongdoing in addition to any penalties that are imposed.
>
> Disgorgement is a vehicle for preventing unjust enrichment. This means that disgorgement orders can offer significant deterrent value by reducing the likelihood that wrongdoers can consider penalties to be merely a business cost.[458]

ASIC noted in that submission that while it could request the Australian Federal Police or the Commonwealth Director of Public Prosecutions to bring confiscation action under the *Proceeds of Crime Act 2002* (Cth), it did not have the power to seek disgorgement in civil penalty proceedings.[459] ASIC has noted many overseas jurisdictions where this sort of remedy is available to government securities regulators.[460] It stated:

> While the precise mechanism of disgorgement varies between jurisdictions, the fundamental feature of disgorgement in all jurisdictions is that the illegal profits gained or losses avoided are removed from the wrongdoer. This is achieved by:
>
> (a) having legislated maximum penalties that are a multiple of the financial benefit obtained from the wrongdoing (New Zealand, Singapore and the United States);
>
> (b) taking into account the financial benefit obtained from the wrongdoing when determining the quantum of penalty that should be imposed (Hong Kong and the United Kingdom); or
>
> (c) having a disgorgement power that is distinct from the ability to impose non-criminal penalties (Canada, Hong Kong, the United Kingdom and the United States).
>
> In contrast, maximum non-criminal penalties for corporate wrongdoing in Australia are set at fixed amounts. As a result, it may not be possible for ASIC or courts to remove the financial benefit obtained from corporate wrongdoing in non-criminal settings even if the maximum penalty is imposed.[461]

While we recommend disgorgement powers for ASIC for breaches of civil penalty provisions generally, we do have some concerns about how these powers would apply in the phoenix context. Disgorgement powers would allow ASIC to remove the gains from Newco or its controllers but the money would be paid into consolidated revenue, rather than being paid to Oldco’s creditors. Where victims of illegal phoenix activity have suffered a loss, we believe

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458 ASIC, above n 436, [28]–[29].
459 Ibid [52].
460 Ibid [30], [56].
461 Ibid [56]–[57].

that the appropriate remedy is to compensate them through the award of compensation or an account of profits under s 1317H, rather than making a disgorgement order in favour of consolidated revenue. In these circumstances, it is unjust for the government to benefit from a windfall, with creditors not receiving funds that might otherwise be recouped by the liquidator for their benefit. Equally, it would be inappropriate for the company or its creditors to obtain a windfall from a compensation order where they have not suffered a loss. While this is unlikely in the phoenix context, it is certainly a possibility in other contexts to which an expanded s 1317H might apply. For this reason, we support giving ASIC the power to seek disgorgement in civil penalty proceedings but that preference be given to compensation orders in appropriate circumstances.

There is broad support for providing ASIC with disgorgement powers. The 2014 Financial System Inquiry ('FSI') recommended that '[t]he maximum civil and criminal penalties for contravening ASIC legislation should be substantially increased to act as a credible deterrent for large firms. ASIC should also be able to seek disgorgement of profits earned as a result of contravening conduct.'[462] The 2014 Senate Committee inquiry into the performance of ASIC recommended that 'Consideration should be given to designing more responsive monetary penalties, such as multiple of gain penalties or penalties combined with disgorgement.[463] In a survey of members of Governance Institute of Australia conducted in early 2016, about 94% of respondents (330 out of 352) 'agreed' or 'strongly agreed' that ASIC should be provided with the ability to require disgorgement.[464]

In response to the FSI's *Final Report*, the government has committed to reviewing ASIC's enforcement regime and penalties in 2017.[465] Our view is that providing ASIC with the power to seek disgorgement in civil penalty proceedings is an important question relating to ASIC's enforcement regime which ought to be considered as part of this review.

Recommendation 30: Remove the benefit of harmful phoenix activity

- Section 1317H of the *Corporations Act* should be amended to include an express power for the court to order Newco to compensate Oldco for gains it has made through the breach of duty of one of Oldco's directors.
- This power should depend upon Newco being an accessory to the breach of duty

[462] Financial System Inquiry, *Final Report* (November 2014) 250, recommendation 29.

[463] *SERC Performance of ASIC Report*, above n 92, [23.12], recommendation 41.

[464] This survey was conducted on Survey Monkey from 21 April 2016 to 13 May 2016. Governance Institute of Australia is a professional association focussing on whole-of-organisation governance that has over 7,000 members, including chartered secretaries, governance advisors and risk managers. Survey on file with author.

[465] Australian Government, *Improving Australia's Financial System: Government Response to the Financial System Inquiry* (2015) 24.

within the meaning of s 79 of the *Corporations Act* or being controlled by the person breaching the duty.

- In addition to amending s 1317H of the *Corporations Act*, ASIC should be given the power to seek disgorgement in civil penalty proceedings.

3.4.4 Clarify accessory orders under the Fair Work Act

An order of compensation can work as effectively as a penalty to deter undesirable behaviour, and has the added benefit of providing redress to those affected by the conduct.[466] Indeed, the compensation order is superior to a penalty precisely because it deprives the phoenix operator of the financial advantage of their behaviour. A small fine, on the other hand, can be seen as 'the cost of doing business', willingly paid by the director as an accessory to their company's breach who continues their business through a new entity. For this reason, Parliament should clarify the right of courts to order compensation against accessories involved in employer companies' breaches of the *Fair Work Act.*

The *Fair Work Act* does not contain any provisions dealing expressly with phoenix activity. However, where an employer company fails to pay wages in contravention of a modern award, this contravenes s 45 of the Act, which is a civil remedy provision. Section 550 of the Act – the accessory liability provision - treats involvement in a contravention of the Act in the same way as the actual contravention by the employer company. This then makes the orders set out in s 545 of the *Fair Work Act* available against the company's directors. These include pecuniary penalties[467] and compensation orders.

In the past, the Fair Work Ombudsman ('FWO') has not sought compensation from accessories in an apparent reliance on the Explanatory Memorandum to the Fair Work Bill, which says that involvement in a contravention of a civil remedy provision can result in a pecuniary penalty being imposed on the accessory but does not make the accessory

[466] See, eg, *Director of the Fair Work Building Industry Inspectorate v Giovanni Italiano* [2013] FCCA 530. The Federal Circuit Court found that Mr Italiano had contravened s 44(1) of the *Fair Work Act* by failing to pay the applicant his unused annual leave when his employment ended. The Court made consent orders requiring Mr Italiano to pay a pecuniary penalty of $1,800 and compensation in the sum of $7,500 payable in instalments to the applicant. The company had been placed into liquidation.

[467] See, eg, *Fair Work Ombudsman v Trek North Tours (No 2)* [2015] FCCA 1801, in which the Federal Circuit Court ordered that the director defendant pay a pecuniary penalty in the sum of $12,000 to the Commonwealth on the basis that he was involved in the company's contraventions pursuant to s 550(1) of the *Fair Work Act*. For further discussion of this judgment, see above n 151 and accompanying text. See also *Fair Work Ombudsman v Something Aussie Pty Ltd* [2017] FCCA 186, in which the director defendant was ordered to pay a pecuniary penalty of $20,280, even though the employees in question had been recompensed in full for the unlawful underpayments in an informal settlement: [14], [31], [39].

personally liable to remedy the effects of the contravention.[468] However, more recently, the FWO mounted a test case to establish its right to seek compensation from the accessory. In *FWO v Step Ahead Security Services Pty Ltd*, the court imposed joint and several liability on the director, after finding that he had been involved in previous failed companies, one of which had failed to pay remuneration.[469]

The availability of a compensation order against an accessory to the company's breach should be clarified by a simple amendment to s 545 of the *Fair Work Act*. At present, it says:

> (1) The Federal Court or the Federal Circuit Court may make any order the court considers appropriate if the court is satisfied that a person has contravened, or proposes to contravene, a civil remedy provision.
>
> [Notes 1 to 4] …
>
> (2) Without limiting subsection (1), orders the Federal Court or Federal Circuit Court may make include the following:
>
> (a) an order granting an injunction, or interim injunction, to prevent, stop or remedy the effects of a contravention;
>
> (b) an order awarding compensation for loss that a person has suffered because of the contravention;
>
> (c) an order for reinstatement of a person.

Section 545(1) should be amended to include the words 'including a person involved in a contravention pursuant to s 550 of this Act'. Section 545(1) would then read as follows:

> (1) The Federal Court or the Federal Circuit Court may make any order the court considers appropriate if the court is satisfied that a person, including a person involved in a contravention pursuant to s 550 of this Act, has contravened, or proposes to contravene, a civil remedy provision.

It is also appropriate that the *Fair Work Act* be clarified so that any order of compensation payable by an accessory in respect of unpaid employee entitlements be paid to the company's liquidator.[470] This deals with concerns about double recovery, where the employees have already received advances from the FEG. The liquidator can return the FEG money to the Department of Employment ('DE') pursuant to the DE's right of subrogation under s 560 of the *Corporations Act*.

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468 Explanatory Memorandum, Fair Work Bill 2009 (Cth) [2175]–[2178]. See also Helen Anderson and John Howe, 'Making Sense of the Compensation Remedy in Cases of Accessorial Liability under the Fair Work Act' (2012) 36 *Melbourne University Law Review* 335.

469 *Fair Work Ombudsman v Step Ahead Security Services Pty Ltd* [2016] FCCA 1482, [78]–[80].

470 It is already open to the court to order that a pecuniary penalty be paid to a person (usually an employee), an organisation (for example, a trade union) or to the Commonwealth: *Fair Work Act* s 546(3).

While the preceding discussion concentrates on the accessory liability of company directors and orders for them to pay compensation, the provision applies equally to advisors outside the company who counsel those directors as to the company's breach. This is appropriate, and the importance of extending liability to advisors is addressed further at [3.5]. For the first time, in early 2016 the FWO commenced action against an accounting firm which allegedly processed wage payments for an employer company, knowing the rates the employees were being paid were well below the lawful minimum.[471] The Ombudsman, Natalie James, has also been speaking directly to advisors and warning them of potential liability.[472]

Recommendation 31: Clarify accessory orders under the Fair Work Act

- Section 545(1) of the *Fair Work Act* should be amended to include the words 'including a person involved in a contravention pursuant to s 550 of this Act'.
- In the context of an insolvent employer, any order of compensation payable by an accessory in respect of unpaid employee entitlements should be paid to the company's liquidator to avoid the possibility of double recovery.

3.5 Expressly address the role of advisors

There is significant concern among regulators and other stakeholders about the role that advisors are playing in facilitating and promoting harmful phoenix activity.[473] This part of the report addresses some of the concerns relating to both professional advisors and unqualified pre-insolvency advisors and proposes a number of recommendations to address these concerns. These include empowering the court to impose conditions on professional licences where advisors have engaged in misconduct and making advisors directly liable for improper advice in addition to being liable as accessories.

471 FWO, 'Accounting Firm Faces Court over Alleged Involvement in Underpayment of Workers' (Media Release, 19 February 2016).

472 See, eg, Natalie James, 'An Adviser's Responsibility: The Fair Work Ombudsman's Approach to Accessorial Liability' (Speech delivered at the Australian Human Resources Institute (AHRI) Employee Relations/Industrial Relations Network, NSW, 27 July 2016).

473 ASIC has identified pre-insolvency advice as an area of focus, observing that it 'is a growing and largely unregulated, unlicenced market': ASIC, *Report 479: ASIC Regulation of Registered Liquidators – January to December 2015* (June 2016) [108]. See also CPA/ASIC, 'Insolvency – At What Cost?' (5 November 2015) *Inpractice*. According to the ATO's national director on phoenix enforcement, Michael Seddon, 'When it comes to pre-insolvency advisors, they are just an unknown for us. They're unregulated and they're unseen until we actually become the victim of it': above n 101. According to our survey of members of ARITA (see above n 25), 77% of respondents 'agreed' or 'strongly agreed' that pre-insolvency practitioners/debt restructurers should be forced to be part of a professional association, while an equal percentage (77%) 'disagreed' or 'strongly disagreed' that they are sufficiently regulated by ASIC. Sixty-nine percent of respondents 'agreed' or 'strongly agreed' that pre-insolvency practitioners/debt restructurers should be subject to the same legal duties as external administrators. According to one respondent, 'There is now an abundance of pre-insolvency advisors who are not subject to any regulations assisting and advising directors to undertake phoenix activity and how to defeat creditors.' Survey on file with author.

3.5.1 Professional advisors

There is no shortage of information about fraudulent phoenix activity from ASIC[474] and the ATO.[475] However, advisors, in giving advice to clients whose companies are in financial crisis, may exploit two areas – what is legal if morally questionable, and what is illegal but unlikely to be uncovered. In relation to the latter, there is a greater role for professional bodies to play in dissuading advisors from facilitating illegal phoenix activity.

Professional bodies, whose role includes updating their members on recent developments, have the incentive to communicate the dangers associated with phoenix activity where they are warning their members against conduct that is likely to result in criminal or civil penalty litigation. In these circumstances, they are likely to relay messages of caution, rather than promote 'loophole seeking'. This educational function on the part of the professional bodies should therefore be complementary to the work of the regulators because it promotes a consistent, rather than contradictory, message.

Disciplinary action against professional advisors who promote illegal behaviour can act as an effective deterrent, particularly where the outcome is a suspension of a professional licence. In circumstances where licence suspension is not available or is not imposed, the fact that a professional advisor has been named as the subject of a disciplinary action may of itself provide a general deterrent, especially in the case of those persons who are motivated to comply with the law by external social factors. These include a desire to be respected by others that are deemed significant and a desire to avoid negative publicity, shame and disapproval that may be associated with an enforcement action. The deterrent impact of the negative publicity may be particularly acute where reputational damage can lead to loss of income.[476]

This is where action against the accessory advisor might operate in a superior manner to actions against the employer. In *Fair Work Ombudsman v Eastern Colour Pty Ltd (No 2)*[477] the court heard that it was industry practice not to pay overtime and that low profit margins in the fruit and vegetables industry arguably necessitated, if not excused, sham contracting arrangements.[478] It is unlikely, therefore, that adverse publicity would cause reputational damage to that type of employer. Haines notes the significance of economic pressures on

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474 See ASIC, above n 106. See also 'ASIC Surveillance Targets Illegal Phoenix Activity' (Media Release, 13-253MR, 9 September 2013).

475 See ATO, *Illegal Phoenix Activity* <https://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illegal-phoenix-activity/>.

476 See [3.3].

477 *Fair Work Ombudsman v Eastern Colour Pty Ltd (No 2)* [2014] FCA 55.

478 Ibid [24], [126]–[129].

business and comments that '[i]f the profit levels are so tight that … compliance is not compatible with staying in business, then … non-compliance is the likely result.'[479]

In contrast, advisors can be adversely impacted if they gain notoriety for giving advice leading to illegal behaviour by the company's directors. In this more informal 'soft regulation' scenario, the example set in one case may work to inculcate desirable behaviour in the advisor's profession in a way that fear of formal prosecution may not. An advisor who fears social ostracism and loss of clients may be better deterred from questionable conduct than an employer who knows that litigation by a regulator is possible but unlikely, even if the punishment could be harsh.[480]

Professional bodies have a key role to play in setting the standards of conduct that regulate their professions and maintain the reputations of their members. In this context, the response to Mr Somerville's accessory liability is of concern. The court in *Somerville No 2* disqualified Mr Somerville from managing corporations. He then returned to court seeking a stay on the disqualification order[481] because his practising certificate was in 'immediate and substantial danger of cancellation'.[482] The Law Society of NSW had served notice[483] requiring him to show cause why he remained a fit and proper person to hold a practising certificate.[484] Barrett J denied the request for the stay on the disqualification on the basis that 'the fact that a stay or like order had been granted is not shown to be something that would or could or might have an influence [on the disciplinary proceedings].'[485]

However, no disciplinary action ever eventuated against Mr Somerville, either by the Law Society of NSW or Legal Services Commissioner, despite the findings of Windeyer AJ as to Mr Somerville's character.[486] Questions of character are critical in a professional discipline

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479 Fiona Haines, *The Paradox of Regulation: What Regulation Can Achieve and What It Cannot* (Edward Elgar, 2011) 22.

480 For a general discussion of the role of fear of disgrace in the eyes of peers, as a sociological explanation of law-abidingness, see Robert A Kagan, Neil Gunningham and Dorothy Thornton, 'Fear, Duty, and Regulatory Compliance: Lessons from Three Research Projects' in Christine Parker and Vibeke Lehmann Nielsen (eds), *Explaining Compliance: Business Responses to Regulation* (Edward Elgar, 2011) 46.

481 Or alternatively, an order granting leave under s 206G to manage a particular company: *ASIC v Somerville* [2009] NSWSC 1149, [1].

482 Ibid [7].

483 It seems likely that this arose as a result of the publicity surrounding the case: ibid [10].

484 Ibid [7]. This notice was served pursuant to *Legal Profession Act 2004* (NSW) s 61.

485 *ASIC v Somerville* [2009] NSWSC 1149, [8].

486 Any cancellation of his practising certificate would need to have been recorded on the Register of Disciplinary Action: *Legal Profession Act 2004* (NSW) s 577. The register can be found at Office of the Legal Services Commissioner (NSW), *OLSC Register of Disciplinary Action* <http://www.lawlink.nsw.gov.au/olsc/nswdr.nsf/ListByName?OpenAgent&Start=S>. A different approach was taken by the Disciplinary Tribunal of CPA Australia in relation to Mr Philip D Whiteman when he went bankrupt owing over $27 million to creditors. The Tribunal ordered Forfeiture of Membership for the period of Mr Whiteman's bankruptcy or for ten years, whichever is the later: CPA Australia Disciplinary Tribunal, *Member Discipline: Mr Philip D Whiteman – Reference 6975* (11 August 2010). For further

context. A statutory regulator which believes that a lawyer is no longer a fit and proper person to hold a practising certificate may take administrative action to withdraw that certificate and hence the lawyer's right to practise.[487] In *Somerville No 2*, Windeyer AJ had made it clear that he did not believe Mr Somerville's sworn affidavit evidence,[488] considered the phoenix arrangements a 'subterfuge'[489] and Mr Somerville's conduct serious.[490] Indeed, in the penalty hearing, Windeyer AJ had noted:

> He continued to give that advice even after he knew that ASIC was conducting the investigations which brought about these proceedings. He agreed that he had been told by Mr Krejci, one of the accountants involved in liquidating some of the companies, that Mr Krejci considered the transactions to be uncommercial but he thought that was incorrect. He said to Mr Krejci that no one had challenged the transactions and "until the Court proves otherwise I will continue to promote them".[491]

This failure to act against what is unquestionably involvement in illegal phoenix activity sends the opposite message to condemnation: it conveys that the courts might exact a penalty against the legal practitioner but that punishment is sufficient, lenient though it may be.

For liquidators, s 536 of the *Corporations Act* gives both the Court and ASIC the power to inquire into the conduct of a liquidator in connection with the performance of their duties, functions and powers, and 'the Court may take such action as it thinks fit.'[492] In *Australian Securities and Investments Commission v McDermott, in the matter of Conalpin Pty Ltd (in liq)*,[493] the court ordered that

> the defendant be prohibited from accepting new appointments as a controller, liquidator or administrator … of a company until the last to occur of:
>
> (i) the third anniversary of this order;
>
> (ii) the provision of the Letter of Satisfaction [regarding peer review of 10 administrations]; and
>
> (iii) the successful completion by the defendant of the ARITA Advanced Certification course referred to … above.

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information regarding the notorious series of alleged incidents involving Mr Whiteman, see above nn 39, 41, 329, 330.

487 See, eg, *Legal Profession Act 2004* (NSW) ss 42, 48, 60 and 66. In New South Wales, the power to issue practising certificates and suspend and cancel practising certificates is vested in The Law Society of New South Wales.

488 *ASIC v Somerville* (No 2) [2009] NSWSC 998, [31].

489 Ibid.

490 Ibid [35].

491 Ibid [30].

492 *Corporations Act* s 447E gives similar powers to the Court in respect of administrators.

493 [2016] FCA 1186.

Similarly, the government should consider whether it is possible[494] and desirable to empower the courts to revoke, or impose conditions upon, other relevant professional licences where an advisor is disqualified from managing corporations by the court or an advisor has been found to be an accessory to a director's breach of duty. The professional licences may include legal practising certificates,[495] accounting practising certificates,[496] Australian Financial Services licences[497] and registration as a tax agent.[498] The purpose of such reforms would be to supplement existing administrative disciplinary powers[499] to avoid the *Somerville* situation, where an advisor facilitates illegal phoenix activity but continues to act in their advisory role.

3.5.2 Pre-insolvency advisors

Exacerbating the difficulties for creditors is the more recent advent of the pre-insolvency or turnaround specialist. Some of these unregulated business advisory services are believed to advise companies in financial difficulties to engage in illegal phoenix activity as a means of saving their businesses from the burden of debt. *ASIC v Franklin*[500] illustrates the operation of pre-insolvency advisors and the difficulties facing ASIC in tackling their behaviour directly. The case was a successful action brought by ASIC for the removal of a liquidator on the basis of apprehended bias. The liquidator was engaged by two failing companies through a referral by the pre-insolvency business advisory group of companies, and it appeared that the pre-insolvency advisors had been involved in phoenix activity.[501] The apprehension of bias arose because the group had previously made a number of referrals to the same

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494 While it dealt with a different issue – the constitutional validity of ss 596A and 596B of the *Corporations Act* – the recent High Court case of *Palmer v Ayres* [2017] HCA 5 is a reminder of the importance of considering the constitutional implications of legislation that gives the courts additional powers to inquire into the conduct of professionals working in connection with the insolvency industry.

495 See, eg, Victorian Legal Services Board and Commissioner, *Applying for a Practising Certificate* <http://lsbc.vic.gov.au/?page_id=207>; The Law Society of New South Wales, *Your Practising Certificate* <https://www.lawsociety.com.au/ForSolictors/practisinglawinnsw/yourpractisingcertificate/index.htm>.

496 See, eg, CPA Australia, *Entering Public Practice* <https://www.cpaaustralia.com.au/professional-resources/public-practice/entering-public-practice>; Institute of Public Accountants, *PPC Eligibility & Requirements* <https://www.publicaccountants.org.au/membersinpractice/mpa/eligibility-requirements>; Chartered Accountants Australian and New Zealand, *Certificate of Public Practice* <https://www.charteredaccountantsanz.com/member-services/being-in-public-practice/certificate-of-public-practice>.

497 ASIC, *AFS Licensees* <http://asic.gov.au/for-finance-professionals/afs-licensees/>; *Corporations Act* s 913A.

498 Tax Practitioners Board (Cth), *Register as a Tax Agent* <https://www.tpb.gov.au/register-tax-agent>.

499 See, eg, *Legal Profession Uniform Law* (NSW) s 53; *Legal Profession Uniform Law Application Act* (Vic) sch 1 s 53; CPA Australia, *Member Conduct and Discipline* <https://www.cpaaustralia.com.au/about-us/member-conduct-and-discipline>; Institute of Public Accountants, *Complaint Investigation & Member Disciplinary Action* <https://www.publicaccountants.org.au/about-us/complaint-investigation-member-disciplinary-action>; Corporations *Act* s 914A; ASIC, *Regulatory Guide 98: Licensing – Administrative Action against Financial Service Providers* (July 2013); *Tax Agent Services Act 2009* (Cth) s 20-40.

500 *Australian Securities and Investments Commission v Franklin (liquidator), in the matter of Walton Constructions Pty Ltd* [2014] FCAFC 85.

501 Ibid [52].

liquidator, and ASIC alleged that the liquidator might not make the required 'vigorous' inquiries if this jeopardised future referrals of work.[502]

Misconduct by pre-insolvency advisors can be dealt with by ASIC bringing an action under s 79 of the *Corporations Act*[503] where the advisors are knowingly concerned in a breach of the law by a company, and/or a company director or officer. It is curious that the action in *ASIC v Franklin* was against the liquidator for apprehended bias, and not the pre-insolvency advisors themselves, where the pre-insolvency advisor's involvement in the phoenix activity seemed clearly indicated on the facts. The 2015 SERC Construction Insolvency Report recommended that ASIC should focus enforcement action on pre-insolvency advisors,[504] and should 'publish a regulatory guide in relation to the nature and scope of pre-appointment advice given or taken by companies.'[505] We agree with these recommendations.

However, courts also have a role to play in ensuring that penalties provide sufficient deterrence. In a case that may or may not have involved phoenix activity, ASIC has reported that pre-insolvency advisor Stephen Charles Hall[506] was 'convicted and ordered to pay a fine of $6,600 for dishonestly aiding, abetting, counselling or procuring another director to breach their director duties … Mr Hall had cold-called a company director who had received a wind up notification from the Australian Taxation Office. After being engaged by the director, Mr Hall aided the director to dishonestly use his position as a company director to conceal the actual ownership of company assets from the liquidator appointed to his company.' We address the issue of increased penalties at [3.4.2].

Recommendation 32: Expressly address the role of advisors

- The government should consider whether it is possible and desirable to empower the courts to revoke, or impose conditions upon, professional licences where
  - an advisor is disqualified from managing corporations by the court, or
  - an advisor has been found to be an accessory to a director's breach of duty.
- ASIC should make greater use of the enforcement mechanism contained in s 79 to bring proceedings against both professional and other pre-insolvency advisors.
- To achieve effective deterrence, courts must impose meaningful penalties on pre-insolvency advisors found to be accessories to directors' breaches of duty.

502 Ibid [53], [91], [110] [124]–[125].

503 The Full Court of the Federal Court of Australia recently examined the operation of s 79 of the *Corporations Act* in *Gore v Australian Securities and Investments Commission* [2017] FCAFC 13.

504 *SERC Construction Insolvency Report,* above n 14, recommendation 40, [12.52]. See also ASIC, above n 408, [198]–[199].

505 *SERC Construction Insolvency Report,* above n 14, recommendation 41, [12.53].

506 ASIC, 'Turnaround Business Advisor Sentenced for Aiding and Abetting Breach of Director's Duty' (Media Release, 16-127MR, 28 April 2016).

4 SOME OTHER IDEAS FROM AUSTRALIA AND ABROAD

This chapter of the report briefly outlines some other ideas for combatting harmful phoenix activity based on domestic and international developments. While we do not have specific recommendations in regard to these developments, we have included them in the report for the sake of completeness and to inform the ongoing policy debate about the regulation of harmful phoenix activity.

4.1 Recovery from other companies

The idea of recovering Oldco debts from other companies deserves examination in Australia. Franchise and labour hire arrangements can be particularly problematic, both within the insolvency context and outside of it. This has become apparent in relation to 7-Eleven workers, trolley collectors and temporary migrant workers in the agricultural sector. In the lead up to the 2016 election, both the Coalition[507] and Labor[508] produced policies to deal with the worst abuses of these vulnerable workers. The Greens also proposed legislation in 2015 to deal with franchisee underpayments of wages.[509] Under the Coalition's proposed changes to the *Fair Work Act*, franchisors and holding companies would be liable for breaches of that Act by their franchisees and subsidiaries if the franchisor or holding company should reasonably have been aware of the breaches, and could reasonably have taken action to prevent the breaches from occurring.

But more needs to be done where labour hire arrangements are coupled with the insolvency of the employer. The Crystal Car Wash case illustrates the issue:

> 4 The statement of claim contended also that the use of labour hire companies, such as the fourth to thirteenth respondents, constituted part of an avoidance system designed to hide the true identity of the employer of the carwash employees and avoid liability under workplace laws. The system was alleged to involve the setting up of labour hire companies at the direction of the second and third respondents, where an employee of the first respondent's carwash business who did not have any experience as a director of a company would purport to be the sole director of the labour hire company. On a weekly, fortnightly or monthly basis the labour hire company would pay the wages of its supposed employees and invoice the first respondent for roughly the same amount. The invoices were prepared by a representative of the first respondent. It is an agreed fact in these proceedings that the first respondent received all of the profits and

507 The Liberal Party of Australia, *The Coalition's Policy to Protect Vulnerable Workers* (May 2016).

508 Fair Work Amendment (Protecting Australian Workers) Bill 2016, introduced into the Senate on 15 March 2016, based on Labor's *Rights At Work* policy: <http://www.alp.org.au/rightsatwork>.

509 Fair Work Amendment (Recovery of Unpaid Amounts for Franchisee Employees) Bill 2015.

takings generated by the operations of the labour hire entities. It was also alleged that certain labour hire entities would be liquidated from time to time and their supposed role as employers would be transferred to newly-created labour hire entities.

5 The respondents denied the allegation that the arrangements were a sham or otherwise uncommercial. However, it was later admitted by the respondents (for the purpose of these proceedings only) that the first respondent was the true employer of the employees.[510]

Insolvency also appears to be a particular issue for sub-contractors and their workers in the building and construction sector.[511] The 2015 Senate Inquiry into insolvency in the Australian construction industry made many recommendations that are taken up in other parts of this report, and indeed, some of the Senate's recommendations reflect suggestions made by our team to that Inquiry. We refer the reader to those recommendations.

4.2 Specific rules for certain industries

Another approach worth considering is to devise 'anti-phoenix' laws that only apply in specific industries. The appeal of this approach is that the rules can be adapted to the particular issues that arise in that industry and therefore they avoid over-reach because of a need to apply more broadly.

One example is industry-based licensing. This might be useful in the financial services industry[512] and the building and construction industry.[513] For instance, the *Queensland Building and Construction Commission Act 1991* (Qld)[514] provides that a person can become an excluded individual if, within the past three years, they are, or were within the previous year, 'a director or secretary of, or an influential person for, the construction company' and

[510] *Fair Work Ombudsman v Crystal Carwash Cafe Pty Ltd (No 2)* [2014] FCA 827. The actions of the liquidators of these companies are under scrutiny: ASIC, 'ASIC Requests Inquiry into Conduct of Sydney Liquidators' (Media Release, 17-014MR, 24 January 2017).

[511] See *SERC Construction Insolvency Report*, above n 14.

[512] Richard St John, *Compensation Arrangements for Consumers of Financial Services* (April 2012) recommendation 2.4: 'To assist ASIC in playing a more pro-active role in administering the licensing regime with respect to compensation arrangements, consideration should be given to clearer powers to enforce standards and to sanction licensees who do not comply through: powers to deal with phoenix activity, both through licensees establishing new entities or by former directors who re-emerge in the industry as authorised representatives; ability to deal with disreputable industry participants; and access to an infringement notice regime.'

[513] See Queensland Building and Construction Commission ('QBCC'), 'QBCC to Keep Eagle-eye on Suspected Illegal Phoenixing' (Media Release, 6 January 2017).

[514] See QBCC, *Excluded Companies and Individuals* (21 August 2015) <http://www.qbcc.qld.gov.au/sites/default/files/Excluded_individuals_and_companies.pdf>.

the construction company had a liquidator appointed, amongst other conditions.[515] The consequence is that the excluded individual, or a company[516] of which they are a director, secretary of influential person,[517] cannot be granted a building licence.[518] Effectively, this means neither the individual nor their company can tender for construction work for which a building licence is required. Even more severe is the permanent exclusion where the individual has twice been excluded temporarily.[519]

However, the 2015 SERC Construction Insolvency Report noted that 'an effective licensing regime is not a silver bullet for the problems of the industry.'[520] We recognise that in industries as complex as building and construction, any reduction of harmful phoenix activity is likely to require many different measures, including work on security of payments legislation. Indeed, the SERC's recommendations spanned corporations and taxation laws as well as those specific to building and construction. Nonetheless, some industry-specific measures may well provide a useful addition to the more general ones set out in this report, and are worth considering especially in industries where harmful phoenix activity is particularly rife.

4.3 Recovery of assets

Ireland's Cahill Duffy Report is a recently completed review looking at protecting employees of insolvent companies when assets are removed.[521] It was prompted by an employer's insolvency following a company restructure where two new companies were created – one holding assets and another operating the business. The lack of money in the operating company resulted in the government being obliged to pay employee entitlements from the Social Insurance Fund under the Insolvency Payments Scheme.[522] The circumstances of the collapse that prompted the inquiry narrowed its terms of reference.[523] The first three proposals concerned the giving of notice to employees about an impending redundancy to allow them the opportunity to negotiate better terms, a requirement under European Union

515 *Queensland Building and Construction Commission Act 1991* (Qld) s 56AC(2) ('*QBCC Act*').

516 'A company is an excluded company if an individual who is a director or secretary of, or an influential person for, the construction company is an excluded individual for a relevant event': ibid s 56AC(6).

517 According to the dictionary in schedule 2 of the *QBCC Act*, an 'influential person, for a company, means an individual, other than a director or secretary of the company, who is in a position to control or substantially influence the conduct of the company's affairs, including, for example, a shareholder with a significant shareholding, a financier or a senior employee.'

518 *QBCC Act* s 56AE.

519 Ibid s 58.

520 *SERC Construction Insolvency Report*, above n 14, [11.4].

521 Nessa Cahill and Kevin Duffy, *Expert Examination and Review of Laws on the Protection of Employee Interests When Assets Are Separated from the Operating Entity: Report to Minister for Jobs, Enterprise and Innovation and the Minister for Business and Employment* (11 March 2016) ('*Cahill Duffy Report*').

522 This is governed by the *Protection of Employees (Employers' Insolvency) Act 1984 to 2012* (Ireland): see *Cahill Duffy Report*, ibid, [1.9].

523 See ibid [2.1].

directives. These are not significantly relevant to harmful phoenix activity in Australia and will not be considered further.

Proposal Four of the Cahill Duffy Report deals with recovering assets where their transfer has the effect of perpetrating a fraud on employees. Ireland, like Australia, already has general provisions dealing with the recovery of preference payments made prior to insolvency,[524] including where there is evidence of deliberate fraud against creditors. The Cahill Duffy proposal adapted the existing Irish provision in the following manner:

> (a) Where collective redundancies arise in circumstances in which the employer is insolvent,
> (b) The employer is unable to fully discharge the debts owing to employees,
> (c) The Minister for Social Protection has made payments under the Social Insurance Fund,
> (d) an asset of significant value had been disposed of either by way of conveyance, transfer, mortgage, security, loan, or in any way whatsoever whether by act or omission, direct or indirect, and
> (e) the effect of such disposal was to perpetrate a fraud on the company's employees, and
> (f) it is just and equitable to do so
>
> the person who appears to have the use, control or possession of the property concerned, or the proceeds of the sale or development of the property can be ordered to restore the asset or its value to the employer.[525]

The Cahill Duffy Report then suggested that:

> To mitigate the potential severity of this provision, it could be provided that it is a defence to such an application for the employer and/or the transferee to produce a directors' statement prepared at the time of the transaction to the effect that all accrued liabilities of the employer were quantified and assessed and the transfer was executed in reliance on a report of an actuary or an accountant to the effect that the employer was in a position to discharge all accrued employee entitlements after the transfer was implemented. Such a provision could also ease the evidential burden of an applicant, as the absence of a directors' statement and actuarial/accounting report could be *prima facie* evidence that the transfer was one with the effect of perpetrating a fraud on

[524] *Companies Act 2014* (Ireland) pt 11 ch 6.
[525] *Cahill Duffy Report*, above n 521, [17.4].

employees. The residual question of whether it is just and equitable to make an order under the provision would remain to be assessed.[526]

The report then considered practical matters. The Minister for Social Protection would have standing to take action to recover these payments,[527] just as the Department of Employment does in relation to FEG payments.[528] It also suggested that the Minister could delegate the recovery of the asset to a liquidator – and fund the liquidator to do so – to take advantage of the liquidator's investigation and evidence gathering powers under the *Companies Act*.[529] As a further practical step, the Cahill Duffy Report suggested the availability of a Mareva injunction to prevent the dissipation of assets in the first place.[530] We have already addressed some of these ideas in our recommendations above. Independent valuations and reverse onuses are discussed at [2.4] and mechanisms to obtain compensation from Newco are explored at [3.4.3].

4.4 Directors' liability for unpaid debts

In the United Kingdom, the Secretary of State may apply to the court for a compensation order against a director who is subject to a disqualification order or disqualification undertaking,[531] where the conduct for which the director was disqualified caused the loss suffered by creditors of an insolvent company.[532] The compensation payable under the order becomes a contribution to the assets of the company for distribution to creditors or a class of creditors.[533] The Secretary of State can apply for the compensation order within two years of a disqualification order being made against a director,[534] or, as an alternative to court action, may accept a compensation undertaking.[535]

In either case, the court or the Secretary of State must have regard to the amount of the loss caused, the nature of the conduct and whether the director has made 'any other financial contribution in recompense for the conduct'.[536]

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526 Ibid [17.6].
527 Ibid [17.7].
528 *Corporations Act* s 560.
529 Cahill Duffy Report, above n 521, [17.7].
530 Ibid [18.1], proposal 5.
531 *Company Directors Disqualification Act 1986* (UK) ss 15A, 15B, 15C, inserted by *Small Business, Enterprise and Employment Act 2015* (UK) s 110.
532 *Company Directors Disqualification Act 1986* (UK) s 15A(3).
533 Ibid s 15B(1)(a).
534 Ibid s 15A(5).
535 Ibid s 15A(2).
536 Ibid s 15B(3).

There is no equivalent Australian provision that allows ASIC to apply for a compensation order against a disqualified person who has caused loss to creditors without a requirement for proof of some form of culpability on the director's behalf. If a director has been disqualified because their actions have caused loss to creditors then it may make sense to allow ASIC to apply to the court for a compensation order in appropriate cases. A compensation order in Australia could depend upon the court taking into account similar factors. On the other hand, if the circumstances of the harmful phoenix activity were sufficiently serious that a compensation order is warranted, it makes sense for ASIC simply to mount a case for breach of directors' duty against the wrongdoer, and for it to seek compensation from the director under the existing s 1317H of the *Corporations Act*. No further law reform would be required.

5 WHAT WE *DON'T* THINK WILL WORK

Harmful phoenix activity has been a cause of concern within Australia for more than 20 years. Many suggestions to tackle it have been mooted over the years. In this chapter of our report, we address a number of those suggestions and explain why they did not make our list of recommendations.

There are also a number of other proposed reforms relating to insolvency that are, or have been, under active consideration in recent years. We take the opportunity here to give our views on those reforms and what we expect their effect on harmful phoenix activity to be. However, we are not evaluating them completely, and we make no assessment of their benefits in other aspects of insolvency versus their detriments.

5.1 Reforms relating specifically to harmful phoenix activity

Here we address the 'usual suspects' – the suggestions that are often made whenever harmful phoenix activity is considered. We understand their appeal but after examining harmful phoenix activity closely for over three years, we have concluded that they would not be effective.

5.1.1 Phoenix offence

Two approaches to designing a phoenix offence have been proposed. The first is to describe the phoenix behaviour. The second is to focus on the re-use of a similar name by Newco.

5.1.1.1 Imposing liability on company directors for phoenix activity

Many people have suggested over the years that a specific phoenix offence is required. This would require phoenix activity to be defined, and for that definition to be able to differentiate legitimate and improper behaviour. We are not in favour of this.[537] In our opinion, no definition can capture the full dimensions of harmful phoenix activity without also capturing legitimate business rescues. In particular, a broad proscription based on describing the circumstances of what occurred may pick up legitimate voluntary administrations.[538] These

[537] For further discussion of our concerns regarding a phoenix offence, see Anderson et al, above n 440.
[538] *Corporations Act* pt 5.3A.

provide breathing space for an administrator to try to save the company.[539] Where the rescue is unsuccessful but a company controlled by the failed company's directors buys its assets, they might find themselves liable under a provision such as this.

A limited provision, on the other hand, is an easily negotiated roadmap to avoidance. For example, the 1995 ASC Phoenix Activity Research Paper defined phoenix activities as:

> […] those where an incorporated entity either:
>
> 1. fails and is unable to pay its debts and/or;
> 2. acts in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts; and
> 3. within 12 months another business commences which may use some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.[540]

An obvious difficulty with the ASC definition is the use of 'intentionally'. It is extremely hard to prove intention in this area, as evidenced by the never-used section dealing with unpaid employee entitlements – s 596AB of the *Corporations Act* – discussed at [3.4.1]. Another difficulty is the use of the word 'commences'. In some instances of phoenix activity, the company to which the business activities of Oldco are transferred is already in existence at the time of the demise of the first. This could be done by the purchase of a previously incorporated shelf company. Shelf companies and incorporation practices are considered above at [1.1.2]. It could also be done within a corporate group where another entity already in existence takes over the defunct company's operations and assets. In some phoenixing, no assets are transferred at all.[541]

Despite these difficulties with legislating against phoenix activity, there are periodic attempts to do so. For example, the Australian Labor Party drafted a provision to impose liability on directors for phoenix activity in early 2016. A private members bill called the Fair Work Amendment (Protecting Australian Workers) Bill 2016 was introduced into the Senate on 15 March 2016 but lapsed with the proroguing of parliament before the July 2016 election. Of particular interest is the Bill's attempt to tackle the adverse consequences of phoenix activity for employees through labour law rather than corporate law, with the Fair Work Ombudsman, rather than ASIC, as the responsible regulator. This contrasts with s 596AB, noted above.

The Labor Bill's main provision of relevance – draft s 545A - imposes liability on executive officers of employer companies for unpaid employee entitlements where they become an

539 *Corporations Act* s 435A.
540 Australian Securities Commission, above n 132, 39.
541 See Anderson et al, *Defining and Profiling Phoenix Activity Report*, above n 1, 1.

executive officer of a 'phoenix' company which is registered within 12 months after the failed company is wound up. The draft section mandates the imposition of the compensation order ('the court must order that the liable person pay …') subject to exempt circumstances where the court can excuse the person. However, while the draft provision was well-intentioned, it created potential problems[542] and serves as a useful example of how difficult it is to proscribe phoenix activity without over-reaching or leaving loopholes to be exploited by unscrupulous business people.

Any phoenix liability provision that attempts to penalise directors acting improperly around the time of liquidation will also fail to address phoenix activity through the abandonment of a company which remains dormant until it is eventually deregistered by ASIC. Abandoned companies are discussed further at [1.3.2] and [2.1].

5.1.1.2 Similar names laws

Australia considered[543] following the example of several overseas jurisdictions, such as the United Kingdom[544] and New Zealand,[545] tackling phoenix activity through similar names legislation. Prior to Christmas 2011, the Federal Government released the exposure draft of the Corporations Amendment (Similar Names) Bill 2012. A similar name is sometimes used for the phoenix company so that customer goodwill can be maintained and so that banks can be induced to allow cheques payable to the previous entity to be paid into the new company's bank account. The draft Similar Names 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.[546] Certain time limits were specified.[547]

According to the draft 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,'[548] with certain matters specified to which the Court must have regard, including 'the extent to which, and the circumstances in which, any assets of the failed company have become assets of the debtor company.'[549] The failed company's liquidator is also empowered

542 These potential problems are explained in Helen Anderson, 'Labor's Policy to Deal with Phoenix Activity Affecting Employees' (2016) 34 *Company and Securities Law Journal* 316.
543 It appears this idea came from the Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [4.2.9].
544 *Insolvency Act 1986* (UK) s 216.
545 *Companies Act 1993* (NZ) s 386A.
546 Exposure Draft of the Corporations Amendment (Similar Names) Bill 2012 (Cth) cl 596AJ(1).
547 Ibid ss 596AJ(1)(b), (d).
548 Ibid s 596AK(3).
549 Ibid s 596AK(4)(b).

to make a similar determination.[550] An exemption is also granted if the failed company has paid its debts in full.[551]

However, the draft Bill's limitations were clearly evident. It did nothing to prevent phoenix behaviour where a different name is used for the new company. 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.[552] 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 a spouse, son or daughter, is appointed director instead.

In our opinion, there is too much scope for similar names legislation to capture legitimate business rescues, and too little scope for it to tackle deliberate phoenix operators, for it to be a viable mechanism against harmful phoenix activity.

5.1.2 Mandatory capitalisation

One of the options proposed in the 2009 Phoenix Proposals Paper was to '[a]dopt the doctrine of inadequate capitalisation … [a]llow the corporate veil to be lifted where a company sets up a subsidiary with insufficient capital to meet the debts that could reasonably be expected to arise.'[553] However, this would be problematic, given the vagueness of what amounts to sufficient capital, whether such capital needs to be maintained throughout the life of the company or is only required at its inception, and so forth. In any event, the lack of assets in a subsidiary company may not be attributable to a lack of initial capital. Rather, a holding company may use its domination of the subsidiary to transfer value to itself, through excessive dividends, overpricing of intra-company sales and under-pricing of purchases, and similar mechanisms.

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550 Ibid s 596AL.

551 Ibid s 596AN.

552 See, eg, *R v William John Walters* [2001] NSWSC 640; [2001] NSWSC 786; [2002] NSWCCA 291, in which each of the defendant's companies had a very different name: Lymkom Pty Ltd; Kindby Pty Ltd; Frego Pty Ltd; Taureema Pty Ltd; Budscan Pty Ltd; Milcoy Pty Ltd; Camotray Pty Ltd; Convoy Pty Ltd; Aloprom Pty Ltd; AJ Australia Pty Ltd.

553 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, vii.

Internationally, capitalisation is a vexed issue, in terms of the companies to which it applies, setting adequacy levels and policing its maintenance,[554] and the trend is away from mandatory capitalisation rules rather than towards them.[555]

5.1.3 Compulsory education for all directors

Anecdotally, we have heard from liquidators and regulators that those found to be engaging in phoenix activity for an improper reason – to deliberately shed the company's debts – claim not to know that their behaviour might breach their duties as directors and other relevant provisions. A number of people have suggested to us that the solution is compulsory education for all would-be directors. Education about the responsibilities of companies and of directors has never been a pre-requisite to becoming a director, and the only reference in the *Corporations Act* to being suitably qualified is that the annual report of 'a public company that is not a wholly-owned subsidiary of another company must also include details of … each director's qualifications, experience and special responsibilities.'[556]

In our opinion, compulsory education for all company directors is not viable. If only applicable to new directors, it would mean that the directors of the 2 million plus existing companies would avoid the requirement, significantly undermining its usefulness in dealing with phoenix activity. The logistics of requiring all directors to attend compulsory education are unimaginable, not to mention prohibitively costly. Even a compulsory disclosure requirement for directors of proprietary limited companies would not be effective. The majority of Pty Ltd companies are not required to publicly report annually,[557] and any market mechanism that makes poorly qualified people unlikely to become directors of public companies does not exist in the SME market where phoenix activity is believed to be most prevalent.

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554 See, eg, John Armour, 'Legal Capital: An Outdated Concept?' (2006) 7 *European Business Organization Law Review* 5; Jennifer Payne, 'Legal Capital Rules in the UK following the Companies Act 2006' in John Armour and Jennifer Payne (eds), *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing, 2009); Jennifer Payne, 'Legal Capital and Creditor Protection in UK Private Companies' (2008) 5 *European Company Law* 220.

555 See The World Bank and the International Finance Corporation, *Doing Business 2014: Understanding Regulations for Small and Medium-Size Enterprises* (11th ed, 2013). Of the 189 economies examined in this report, 99 had no minimum capital requirements. Some jurisdictions never required capital on incorporation, while 39 eliminated minimum capital requirements in the preceding seven years. Numerous other countries have significantly reduced mandatory capitalisation: at 41. See also Eilís Ferran and Look Chan Ho, *Principles of Corporate Finance Law* (Oxford University Press, 2nd ed, 2014) 75–82.

556 *Corporations Act* s 300(10)(a).

557 Ibid s 292(2).

However, in the case of multiple previous failures, a set of restrictions should apply to directors who seek the privilege of incorporating another company. Voluntary education for these people is explored, along with other possible consequences, at [2.1.2].

5.1.4 ATO statutory priority

The ATO's statutory priority as an unsecured creditor in a liquidation was removed in 1993.[558] This should not be reinstated, nor should there be any 'super-priority' for the ATO over secured creditors.[559] This simply has the effect of disadvantaging other creditors, especially the main group of priority unsecured creditors - employees - who are more likely to need recourse to the Fair Entitlements Guarantee. Redressing the loss of one victim of harmful phoenix activity should not come at the expense of other victims.

5.1.5 Additional tax crimes

As our *Defining and Profiling Phoenix Activity* report noted, there are already a range of tax provisions that can be utilised against those deliberately liquidating a company to avoid the company paying its tax liabilities. For example, under the *Criminal Code Act 1995*, the behaviour breaches the defraud prohibition under s 135.1 or constitutes conspiracy to defraud under s 135.4. In addition, the *Crimes (Taxation Offences) Act 1980* (Cth), that was introduced following 'bottom of the harbour' tax evasion in the 1970s, imposes criminal sanctions where a person enters into an arrangement with the intention of securing that a company will be unable to pay income tax or a range of other taxes including the superannuation guarantee charge.[560] Aiding and abetting such an arrangement or transaction by another is also covered.[561] 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.[562]

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558 See Helen Anderson, 'Directors' Liability for Unpaid Employee Entitlements: Suggestions for Reform Based on their Liabilities for Unremitted Taxes' (2008) 30 *Sydney Law Review* 470, 471. The ATO's statutory priority under the *Income Tax Assessment Act* 1936 (Cth) was removed by way of amendments introduced via the *Insolvency (Tax Priorities) Legislation Amendment Act* 1993 (Cth).

559 See *Commissioner of Taxation v Australian Building Systems Pty Ltd (in liq)* [2015] HCA 48, which confirmed that a liquidator is not required to retain from the proceeds of sale of an asset enough money to pay a capital gains tax liability that would accrue after the liquidation commenced.

560 *Crimes (Taxation Offences) Act 1980* (Cth) ss 5, 17. In its submission to Treasury in response to the 2009 *Phoenix Proposals Paper*, accountants and business advisory firm Pitcher Partners argued that this Act is an 'ideal "vehicle" … for taking action to address fraudulent phoenix activity': Pitcher Partners, Submission to Treasury (Cth), *Action against Fraudulent Phoenix Activity: Proposals Paper*, 8 January 2010, 5 <http://archive.treasury.gov.au/documents/1892/PDF/Pitcher_Partners.PDF>. See also Lidia Xynas, 'Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance' (2011) 20(1) *Revenue Law Journal* 1.

561 *Crimes (Taxation Offences) Act 1980* (Cth) ss 6–7.

562 See, eg, ATO, *Taxpayer Alert TA 2008/16: Liquidation of Entities to Avoid the Payment of Tax Liability* (25 June 2008).

However, these provisions do not appear to be utilised in the phoenix context. A possible explanation for the lack of use of these provisions may be that criminal offences, involving as they do the requirement to prove the elements of the offence beyond reasonable doubt,[563] are simply too difficult to establish in this context. There are too many possible interpretations of the motives for behaviour in the phoenix realm. For this reason, we do not recommend any more criminal offences aimed at phoenix activity be created.[564]

The Proposals Paper suggested consideration of reintroducing the 'failure to remit' offence, which was removed in 2000.[565] Such an offence, coupled with s 8Y of the *Taxation Administration Act* (making directors liable for the tax offences of their company) and s 21B of the *Crimes Act 1914* (allowing the court to order reparation), would effectively punish phoenix activity and redress the damage at the same time. It is an appealing idea because of its ability to deprive the phoenix operator of the benefit of their behaviour. It could even be used where the company is in liquidation, despite the existence of the parallel DPN regime.[566] However, like all criminal provisions, it suffers from the requirements of proving the basic criminal offence, although as far as the accessory liability goes, the onus of proof is on the defendant to prove that he or she was not 'concerned in' or did not 'take part in' the management of the company.[567]

In the event that the ATO does have suitable cases warranting criminal proceedings against phoenix operators and their advisors as accessories, we suggest they be mounted under the *Criminal Code Act 1995* or the *Crimes (Taxation Offences) Act 1980* (Cth). *R v Iannelli*[568] reminds the ATO that such a case under the *Criminal Code* needs to display the requisite intent to defraud, and that the bare failure to remit withholding taxes is not sufficient to discharge this burden. Amendments to the general anti-avoidance rule and the promoter penalty regime are considered below at [5.1.6].

5.1.6 Tax civil penalty provisions

Treasury's Phoenix Proposals Paper acknowledged the difficulties of using criminal prosecutions against harmful phoenix activity and mooted amendments to two civil penalty provisions – the general anti-avoidance rule and the promoter penalty regime. We do not support these ideas for the following reasons.

563 See, eg, *R v Iannelli* [2003] NSWCCA 1.
564 For other reasons, we also do not recommend the creation of additional tax civil penalty provisions: see [5.1.6].
565 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [4.2.5].
566 *Gould v Federal Commissioner of Taxation* (1998) 147 FLR 173.
567 *Taxation Administration Act* s 8Y(3).
568 [2003] NSWCCA 1.

5.1.6.1 Reform of the general anti-avoidance rule (GAAR)

The Proposals Paper suggested that the general anti-avoidance rule ('GAAR') in Part IVA of the *Income Tax Assessment Act 1936* (Cth) could be amended to encompass phoenix activity by overcoming certain present limitations.[569] The current provision speaks of a 'tax benefit'[570] being obtained from a scheme with the sole or dominant purpose of obtaining that benefit. The scheme benefit is that less tax is levied. This does not cover the phoenix context, which involves tax not being paid rather than not being levied. It is also hard to argue that avoiding tax is the sole or dominant purpose of phoenix activity, where the avoidance of a wide number of debts – for example, employee entitlements, unsecured debts, adverse judgments and fines as well as taxes - may be the motivation. The outcome of a breach of the GAAR is that the Commissioner may then remove the benefit from the entity.[571] Again, in the phoenix context, this remedy is ineffective because the entity is insolvent and the Commissioner remains an unsecured creditor of the company.

The Proposals Paper made a number of suggestions for working around these limitations.[572] One was to redefine 'tax benefit' to include non-payment of tax and another was to allow recovery of the tax benefit from the new company. The Proposals Paper justified this approach with reference to state payroll tax laws that allow recovery from group companies.[573] However, recovery from group companies[574] and recovery from the new company are not the same thing. In any event, the *Corporations Act* already allows ASIC, and the company's liquidator, to pursue uncommercial transactions as insolvent trading and to recover the amount of the benefit obtained.[575] How to remove the benefit of harmful phoenix activity is discussed further at [3.4.3].

While the appeal of a GAAR, modified to deal with phoenix activity, is understandable, any test requiring proof of a sole or dominant purpose of avoiding *payment* of taxes is likely to be very hard to achieve. A scheme to avoid incurring a liability, designed for a solvent company, is much easier to discern than a scheme to avoid paying a debt in the midst of an insolvency. On the other hand, a removal of the purpose test has the capacity to over-reach and impose strict liability on the new company for the unpaid taxes of another entity.

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569 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [3.1.3].
570 *Income Tax Assessment Act* s 177C.
571 Ibid s 177F.
572 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [4.2.4].
573 Ibid.
574 *Corporations Act* pt 1.2 div 6.
575 Ibid ss 588FB, 588G(1A) item 7; above n 386.

5.1.6.2 Reform of the Promoter Penalty Regime

The Proposals Paper noted the option of revising the promoter penalty regime[576] to discourage those designing and advocating tax schemes to exploit the corporate form.[577] The idea here is to impose a civil penalty[578] on those who advise company directors to phoenix their companies. Existing ways to punish advisor accessories are discussed at [3.5].

As with the GAAR, the current promoter penalty provisions are not effective with phoenix activity because the company's tax liability is unaffected. The company has simply failed to pay what it properly owes. The current promoter penalty provisions target those who market and encourage the growth of a scheme[579] and exclude entities that simply advise about the scheme.[580] The vast majority of phoenix activity advisors would fall into the latter category and escape liability.

The Proposals Paper suggested the option of amending the promoter penalty regime in a similar way to the GAAR.[581] Here, we question whether the provision might either be too difficult to prove where the phoenix activity is included in the scope of a 'tax exploitation scheme'[582] or else over-reach if more moderate language were adopted. Advisors who tell their clients that they should liquidate their companies which are facing insolvency are giving proper advice and should not be penalised.

5.2 Reforms relating to corporate insolvency generally

The following three issues – prepacked liquidations, streamlined liquidations and a safe harbour defence – have all been considered recently in Australia. Our discussion does not claim to evaluate them holistically. Rather, we take this opportunity to point out how these ideas might impact upon harmful phoenix activity.

576 *Taxation Administration Act* sch 1 div 290.
577 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [4.2.3].
578 *Taxation Administration Act* sch 1 s 290-50.
579 Ibid sch 1 s 290-60(1).
580 Ibid sch 1 s 290-60(2).
581 Treasury (Cth), *Phoenix Proposals Paper*, above n 8, [4.2.3].
582 *Taxation Administration Act* sch 1 s 290-65. It requires proof of the sole or dominant purpose of the scheme being a benefit that is not reasonably arguably available at law.

5.2.1 Pre-pack process for Australia

In the United Kingdom, the *Enterprise Act 2002* (UK) introduced provisions for the appointment of an administrator to be made out of court,[583] and has contributed to an apparent increase in the numbers of pre-packaged administrations[584] since the reforms came into effect.[585] 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 a 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, appointment.'[586] 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.[587] This is especially significant where *not* rescuing the company would result in a better return to creditors as a whole.

Undoubtedly, the preservation of the company's business has the capacity to save jobs and goodwill,[588] and one might assume that 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,[589] and they are presented with a *fait accompli*. However, it is difficult to ensure that the 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

583 Previously a court order was required, but according to the *Insolvency Act 1986* (UK) 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 also Gerard McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Edward Elgar, 2008) ch 3.

584 See Sandra Frisby, *Report to the Association of Business Recovery Professionals: A Preliminary Analysis of Pre-packaged Administrations* (August 2007); Peter Walton, 'When is Pre-Packaged Administration Appropriate? – A Theoretical Consideration' (2011) 20 *Nottingham Law Journal* 1, n 7; Vanessa Finch, 'Pre-Packaged Administrations and the Construction of Propriety' (2011) 11 *Journal of Corporate Law Studies* 1; Rebecca Parry, 'Is UK Insolvency Law Failing Struggling Companies?' (2009) 18 *Nottingham Law Journal* 42, 45–7, n 13.

585 See UK Insolvency Service, *Report on the First Six Months' Operation of Statement of Insolvency Practice 16* (June 2009) [2.3], which showed a growth in the number of administrations in general. However, there is no obligation for administrators to report pre-packs as such.

586 The Institute of Chartered Accountants in England and Wales, *Statement of Insolvency Practice 16: England and Wales – Pre-packaged Sales in Administrations* (effective from 1 November 2015) 1.

587 According to *Insolvency Act 1986* (UK, sch B1 para 3(3), '[t]he 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.'

588 UK Insolvency Service, *Enterprise Act 2002 – Corporate Insolvency Provisions: Evaluation Report* (January 2008) 147.

589 Therefore, pre-packs are not consistent with the Cork Report, which recommended a more active role for ordinary creditors in insolvency proceedings: Sir Kenneth Cork, *Insolvency Law and Practice: Report of the Review Committee* (June 1982) [914], [917], [919].

associated with the company previously may facilitate fraudulent phoenix activity.[590] Thus, while the speed of the procedure might maximise its benefits, it contributes to a lack of transparency[591] that engenders suspicions of unfair dealings.[592]

As noted above at [2.4], in the United Kingdom in June 2014, Theresa Graham concluded a report on pre-packs for the Secretary of State for Business, Information and Skills.[593] Although they have been the subject of much debate, pre-packs are not common in the United Kingdom, making up about 3.25% of insolvencies and about 0.26% of all exits.[594] The Graham Review confirmed that pre-packs can preserve jobs but that they lack transparency and adequate testing of the market for the sale of the company's assets. Graham made a number of recommendations to increase the scrutiny of pre-pack administrations, particularly those involving connected party sales. Many of these recommendations were incorporated into a revised SIP 16, effective as of 1 November 2015.[595]

However, it is too early to tell whether these revisions will increase transparency and public perception of fairness in the pre-pack process. There is also potential for further, more extensive reform of the pre-pack regime in the United Kingdom in coming years. Under section 129 of the *Small Business, Enterprise and Employment Act 2015*, the UK Government has reserved the right to enact legislation controlling pre-pack sales to connected persons in the event that the insolvency industry fails to comply with the revised SIP 16.

The Productivity Commission in Australia considered 'pre-positioned' sales in its 2015 Business Setup report.[596] It recommended that:

> Where no related parties are involved, there should be a presumption of sale such that administrators can overturn sales only if they can prove that the sale was not for reasonable market value (in accordance with s420A of the Act), or if it would unduly impinge on the performance of the administrators' duties. Administrators or liquidators should be allowed to rely on the pre-appointment sale process as evidence.

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590 See Finch, above n 584, 5. See also QBCC, above n 513.

591 See Vanessa Finch, 'Corporate Rescue: Who is Interested?' (2012) 3 *Journal of Business Law* 190, 199. Information comes belatedly, not for the process of agreeing to the rescue proposal but rather for holding the insolvency practitioner to account.

592 See, eg, Parry, above n 584, 47; Finch, above n 584, 6. For judicial recognition of possible problems with pre-packs, see *Re Kayley Vending Ltd* [2009] BCC 578; [2009] EWHC 904 (Ch). According to Frisby, above n 584, 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 on average 1% of their debts, compared to 3% in standard business sales: at 53, 56.

593 *Graham Review*, above n 317.

594 These percentages are calculated based on the number of exits, insolvencies and pre-packs reported in the *Graham Review*, ibid, 4.

595 Institute of Chartered Accountants in England and Wales, above n 586; *Graham Review*, above n 317, recommendation 3, annex A.

596 Productivity Commission, *Business Set-up Report*, above n 16.

> If sales are to related parties, there is no presumption favouring sale and the administrator's or liquidator's examination of the sale process continues as normal. The administrator's review should include checks that the sale has met existing regulatory requirements for related party transactions.
>
> In both cases, s439A of the Act should be amended to include requirements to disclose information of the sale to creditors.[597]

We are concerned that pre-packs, as they exist in the United Kingdom, and as they are proposed for Australia, may facilitate harmful phoenix activity. Their availability may send a message that significant asset transfers prior to insolvency, precipitating the external administration of the company, are acceptable. In particular we are concerned that the proposed 'related party' distinction is a roadmap for utilising the procedure to conceal undervalued transactions. We do favour the independent valuation of asset transfers to related parties outside of the pre-pack context: [2.4], but not utilising the flawed 'related party' definition from s 228 of the *Corporations Act.*

In addition, the reverse onus suggested by the Productivity Commission – where the administrator is obliged to overcome a presumption that a non-related party sale is for market value – puts the detection and enforcement burden on the administrator who may lack the financial ability to litigate the matter. The considerable burden already on liquidators is considered at [3.1].

5.2.2 Streamlined liquidations

The Productivity Commission Inquiry into Business Set-up, Transfer and Closure looked into streamlining the liquidation process for companies with few assets and liabilities. The Final Report noted that

> a significant proportion of liquidations involve companies with few assets (41 per cent are 'assetless' at the time of insolvency, and a total of nearly 80 per cent have less than $50 000 assets at insolvency) and relatively small liabilities (43 per cent of failed companies had estimated liabilities of $250 000 or less, and another 33 per cent of failed companies had estimated liabilities of between $250 000 and $1 million).[598]

[597] Ibid recommendation 14.3, 37, 392.
[598] Ibid 404.

The Commission was concerned that

> a detailed investigation by a liquidator will incur legitimate costs that can (more than) consume the remaining assets – leaving creditors with no returns and insolvency practitioners bearing the costs. This has required liquidators to cross subsidise with other activities in order to remain profitable themselves – the Commission considers this neither efficient nor equitable. [599]

ASIC's submission to the Commission supported the idea of a streamlined external administration process to reduce costs,[600] and the idea was also supported by submissions from certain insolvency practitioners and ARITA. In essence, the model for liquidations with unrelated parties' liabilities less than $250,000 would reduce processes such as calling meetings, reporting to creditors and conducting investigations. Creditors would still have the option of a full liquidation. To avoid collusion by 'friendly' liquidators, as the report calls them,[601] misrepresenting the amount of liabilities to qualify for the streamlined liquidation process, the Commission suggested a '"next cab off the rank" system from the pool of providers (administered by ASIC).'[602]

The Commission's recommendation[603] noted that 'ASIC would be able to initiate further investigation if it has concerns of illegality' but that

> [t]he pursuit of unfair preference claims should be limited to those within three months of insolvency and of material amounts. The duty to pursue unfair preferences should be explicitly removed unless there is a clear net benefit and it will not impede conclusion of the liquidation.'

There are three related issues in the streamlined liquidation debate: liquidator collusion; liquidator funding; and the notion that small liquidations should not involve substantial time or investigations and therefore cost. The Commission sought to deal with funding with recommendation 15.2:

> In instances of small liquidations where a liquidator is unable to recover funds to cover their own fee, and where the Australian Securities and Investments Commission (ASIC), is satisfied that the activities are not excessive, the liquidator should be able to apply for the balance of their fees to be paid through ASIC.
>
> - The existing Assetless Administration Fund should be renamed the Public Interest Administration Fund and its objectives and funding modified to reflect this new function.

599 Ibid.
600 Ibid 404–5.
601 Ibid 407.
602 Ibid 408.
603 Ibid recommendation 15.1.

- To the extent that this requires additional funding, it should be raised by increasing the annual review fee for company renewals.

Funding should also be available from the Public Interest Administration Fund in instances where ASIC initiates further investigations beyond those required by the small liquidation process.

What is unclear is the extent to which the Commission expects the liquidator to investigate and take action. On the one hand, it appears to be saying that these small liquidations should not cost much and should be expedited, including by reducing investigations and the recovery of preferences. On the other, it expects these 'independent' liquidators to be able to detect wrongdoing, escalate the matter to ASIC where appropriate and seek further funding to do so. To qualify for funding, these liquidators must jump the hurdle that their investigations were not 'excessive'. This is likely to be assessed after the fact and only considered 'not excessive' if something significant has been discovered. How can the liquidator know this before they start investigating? Why should they bother?

In our opinion, this is trying to have your cake and eat it, and the streamlined liquidation proposal would further facilitate harmful phoenix activity. 'Independent' liquidators who are paid a minimal amount and who are encouraged to speed the process would have neither the duty, the time nor the incentive to delve below the surface of transactions. A phoenixed company can easily be made to appear a legitimate business rescue. This is particularly the case where the failed company has already been through the hands of a colluding pre-insolvency advisor who has prepared the scene of the crime for the underfunded, under-motivated liquidator to investigate.

5.2.3 Safe harbour defence to insolvent trading

In January 2010, Treasury issued a discussion paper on the operation of Australia's insolvent trading laws in the context of attempts at business rescue outside of external administration.[604] The paper suggested that directors could be encouraged to fight to save their businesses, resulting in the preservation of jobs, with the introduction of a 'safe harbour' defence, similar to the business judgment rule defence to an allegation of breach of the duty of care and diligence.[605] This would give directors some ability to choose a third path, rather than the present choice between liquidation or voluntary administration. It acknowledged that

[604] Treasury (Cth), *Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration* (January 2010).

[605] See also Jason Harris, 'Director Liability for Insolvent Trading: Is the Cure Worse than the Disease?' (2009) 23 *Australian Journal of Corporate Law* 266.

directors of companies in financial difficulties could be tempted to engage in insolvent trading to benefit themselves as shareholders, at the expense of creditors.[606]

In addition, it recognised that the 'laws against insolvent trading are therefore an important tool in addressing phoenix company behaviour' because 'phoenix company behaviour involves the transfer of assets out of a company instead of applying them toward the payment of the company's liabilities, [so] it commonly involves the company, at some point, carrying on business without the capacity to meet its liabilities as they become due.'[607] The 2010 proposal was not adopted, but the idea of a safe harbour was revived by the Productivity Commission in the Business Set-Up, Transfer and Closure Inquiry Report. Its recommendation 14.2 was as follows:

> The *Corporations Act 2001* (Cth) should be amended to allow for a safe harbour defence to insolvent trading. The defence would only be available when:
>
> - directors of a company have made, and documented, a conscious decision to appoint a safe harbour adviser with a view to constructing a plan to turnaround the company
> - the adviser was presented with proper books and records upon appointment, and can certify that the company was solvent at the time of appointment
> - the adviser is registered and has at least 5 years' experience as an insolvency and turnaround practitioner
> - directors are able to demonstrate that they took all reasonable steps to pursue restructuring
> - the advice must be proximate to a specific circumstance of financial difficulty, and subject to general anti-avoidance provisions to prevent repeated use of safe harbour within a short period.
>
> The defence would not attach to any particular decision and instead would cover the running of the business and any restructuring actions from the time of appointment until the conclusion of (reasonable) implementation of the advice.
>
> - If the adviser forms the opinion that restructure into any form of viable business or businesses is not possible, they are under a duty to terminate the safe harbour period and advise the directors that a formal insolvency process should commence.
>
> The safe harbour adviser may only be appointed in a subsequent insolvency process with leave of the court.[608]

606 Treasury (Cth), above n 604, [3.5].
607 Ibid [3.6].
608 Productivity Commission, *Business Set-up Report*, above n 16, recommendation 14.2, 37.

The Turnbull Government has made the adoption of a safe harbour one of the planks of its Innovation Agenda insolvency policy.[609] In April 2016, it released a proposals paper seeking feedback on two possible models for the safe harbour. [610] The essential difference between the models is that under Model A, the safe harbour would be a defence that the director would be required to establish. Under Model B, the safe harbour would be a carve-out of the liability provision, so that the onus would be on the liquidator to establish that the carve-out did not apply. In addition, Model B does not formally require the involvement of a restructuring advisor.

In our opinion, the safe harbour proposal as described by the Productivity Commission is neither the solution for phoenix activity nor does it exacerbate the problem. It is voluntary, so directors wanting to avoid the scrutiny of a 'safe harbour adviser' will simply avoid the process. The requirement for a court order to allow a safe harbour advisor in a subsequent insolvency should remove the temptation to utilise this mechanism for repeated phoenix activity.

However, we make mention of the safe harbour proposal in this report because the government's Insolvency Laws proposals paper's Model B has removed the requirement of an independent advisor and is placing the onus of proof on the liquidator. This suffers from all the issues that bedevil phoenix activity enforcement at present (see Chapter 3) and therefore does have the capacity to increase the incidence of harmful phoenix activity.

[609] Australian Government, *National Innovation & Science Agenda: Welcome to the Ideas Boom* (2015) 7.

[610] Australian Government, *National Innovation & Science Agenda: Improving Bankruptcy and Insolvency Laws – Proposals Paper* (April 2016).

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