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[redacted]

RESTRUCTURING FORENSIC INSOLVENCY

28 November 2019

The Director
Australian Law Reform Commission
PO Box 12953
GEORGE STREET QLD 4003

Dear Sir,

Submission
Discussion Paper 87: Corporate Criminal Responsibility
Section 11 Illegal Phoenix Activity

I am a Chartered Accountant and registered company liquidator, with more than 30 years of experience in accounting and insolvency.

I wish to make the following submissions in relation to Section 11 Illegal Phoenix Activity of Discussion Paper 87.

Comments

1. Detection of illegal phoenix activity

In my experience, contrary to the statement contained at paragraph 11.16 of the discussion paper, there are many phoenix companies that are **not notoriously difficult to detect**. Furthermore these phoenix companies **can be easily detected following a single company failure**.

For these phoenix companies, when the company is placed into liquidation the only creditor of the company is shown in the documents provided to the liquidator to be the Australian Taxation Office ('ATO'). All of the other creditors have been paid except for the taxation debts.

I first encountered phoenix companies when undertaking insolvency administrations in the 1980's. Some companies placed into liquidation had only one creditor which was the ATO. Investigations carried out on the company indicated that the directors had transferred the business to another company which had commenced trading, but this second company needed the support of suppliers to the business in order to be able to trade, so the directors paid the debts of the suppliers which were creditors of the first company but they did not pay the ATO.

When examined, invariably the directors revealed that the advice to undertake this phoenix company scenario came from the company's external accountant or 'tax accountant'.

In my experience, tax accountants (some but not all of them) have continued to be the main perpetrators of this type of phoenix company scenario and it is still the most common type of phoenix company.

2. The term 'a legal phoenix company' is inappropriate

In my view there is no such thing as 'a legal phoenix company'.

In my experience the term phoenix company was first used to describe the abovementioned company that when liquidated only had one creditor being the ATO as the other creditors had been paid in full. However over the years phoenix companies have become more complex, due in part to attempts by directors and their advisers to manipulate the GEERS/FEG funding available to pay employees or simply to avoid paying employee claims and other debts.

When a company is near to or is insolvent the directors must cease trading in order to prevent incurring a debt that the company is unable to pay (s.588G Corporations Act 2001). The new 'safe harbor' provisions of s.588GA provide an exception to this requirement if a better outcome can be achieved

Also once the company has reached the point of insolvency or near insolvency the directors are required take into account the interests of the company's creditors as well as the shareholders (*Walker v Wimborne [1976] HCA 7; (1976) 137 CLR 1.7*).

The options available to directors when the company is insolvent are liquidation or voluntary administration for the company. Voluntary administration allows the company to trade on in the future if the creditors agree to a Deed of Company Arrangement ('DOCA') proposal. However the term 'phoenix company' is neither applicable to nor generally used for a company that has executed a DOCA and continued to trade after doing so because it is no longer insolvent.

Thus I don't understand why the term 'a legal phoenix company' has been used in the discussion paper. In my view a phoenix company is a derogatory term that is applicable to situations where the claims of creditors of the company have not been dealt with equally or fairly and contrary to the 'pari-passu' principles of the Corporations Act and common law, but the company or its business has continued to exist. The term phoenix company should be reserved for these companies.

The other situation, where a company has been restructured and can trade on because it is no longer insolvent is simply referred to as a restructuring.

Question J

I consider that there should be an express statutory power to disqualify insolvency and restructuring advisors who are found to have contravened the proposed creditor-defeating disposition provisions.

Company liquidators and administrators are the first line of detection and defence against phoenix companies. They have statutory duties to investigate an insolvent company's affairs, whether acting as liquidator or administrator. By virtue of their role they may be the only person in a position, and with the available information, to be able to detect and investigate a phoenix company scenario.

Thus, in my view, a registered liquidator that participates in a phoenix company scenario (for which the discussion paper uses the term an illegal phoenix) by either not undertaking a proper investigation, not reporting offences to ASIC, not undertaking actions for the recovery of assets or in the worst case scenario being a participant in advising and planning a phoenix company, is guilty of

corruption. I support disqualification orders and additional penalties, including civil (financial) and criminal penalties, for registered liquidators who participate in phoenix company scenarios.

The discussion paper talks about pre-insolvency advisers. However it does not mention general advisers such as tax accountants and others who often consider that phoenix companies are part of acceptable asset protection planning and advice.

After the rise of tax avoidance schemes the Institute of Chartered Accountants in Australia responded to the avoidance of income tax and the financial devastation often caused to innocent people by such schemes, by banning its members from any involvement in tax schemes. I consider that a similar stance needs to be taken by all of the professional bodies in relation to schemes that are designed to put assets out of the reach of creditors.

The problem is not new. The prohibition of creditor defeating dispositions of The Combating Illegal Phoenixing Bill are, in my view, importing into the Corporations Act similar provisions to the 'prohibition of fraudulent dispositions to defeat creditors' provisions contained in the Property Law Acts of each State. These provisions of the Property Law Acts are said to have been derived from the Elizabethan Statute and so the problem appears to have been around for centuries (see *'Avoiding property transactions made with the intention to defraud creditors – principles and practice'* by Scott Aspinall & Scott Richardson, Barristers, Ground Floor Wentworth Chambers, 26 July 2017). In this context Phoenix companies are simply the latest scheme devised for the alienation of property from creditors.

Question K

I consider other actions that could be taken to combat phoenix companies are:

3.1 Deregistration

An area open to tax accountants and their clients to undertake phoenix company scenarios is abuse of the deregistration provisions of the Corporations Act 2001. When a company is voluntarily deregistered no investigation of the company is undertaken as a liquidator or administrator is not appointed. Thus a company is able to avoid scrutiny of its dealings through deregistration.

It is often claimed that protection against abuse of the voluntary deregistration procedure is provided because the director must file a statement of the company's financial position with the application for deregistration. However this is not an effective device where assets having been stripped or transferred to a phoenix company prior to the application for deregistration. Moreover a statement of financial position does not reveal the company's past dealings and affairs.

In my experience tax accountants are aware that companies are automatically deregistered by ASIC where they have not filed annual forms and documents. These companies escape any scrutiny of their dealings and affairs, and of their assets and liabilities. Thus directors and their advisers can simply wait for this process to be undertaken to avoid scrutiny of the company.

The steps needed to close this loophole include:

a. establishment of director identification numbers (i.e. Proposal 23 of the discussion paper);
b. cross-referencing and checking of director identification numbers for all companies that are in the process of being deregistered before they are deregistered;
c. compulsory tax clearances for all companies that are in the process of being deregistered before they are deregistered;

d. compulsory appointment of liquidators by ATO and/or ASIC to companies which generate concerns after the checks described at points b. and c. above have been undertaken instead of deregistration.

3.2 Change of company name

Similarly the changing of a company's name to a name that is simply its ACN should automatically generate concern with the regulators that its true identity is being hidden and/or that its former company name has been transferred to another company controlled by the same directors/shareholders.

I consider that any application for a change of name for a company to its ACN should be investigated before approval is given.

Yours faithfully,

[redacted]

Russell Morgan