Submission to Treasury:

Comments on Exposure Draft-

Corporations Amendment (Phoenixing and Other Measures Bill) 2012

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This paper aims to offer views on the Exposure Draft- *Corporations Amendment (Phoenixing and Other Measures Bill) 2012* (**Exposure Draft**). Comments made in this paper will focus specifically on the proposed provisions which relate to Australian Securities and Investments Commission (**ASIC**)'s ability to wind up companies administratively. This paper does not intend to down play the significance of phoenix activities or the importance of finding remedies to curb fraudulent phoenix activities. Instead, it offers alternative law reform options of amending provisions within the *Corporations Act 2001* (Cth) (**Corporations Act**) which relate to the ability to wind up or reinstate companies in order to combat those who conduct or facilitate fraudulent phoenix activities.

Generally, ASIC can administratively disqualify a person from managing corporations for a period of time by having regard to the following grounds: the person's conduct in relation to the management of the relevant corporations, whether the disqualification would be in the interest of the public and any other matters that ASIC considers appropriate pursuant to subsection 206F(2) of the Corporations Act. Unlike s 206F of the Corporations Act, the Exposure Draft proposes some limited considerations that an ASIC Delegate must take into account when he or she administratively appoints a liquidator to take over the conduct of the company (i.e. proposed s 489F is silent on considerations such as conduct and public interest).

The Exposure Draft explained that the considerations proposed under s 489F derived from the possibility of directors abandoning companies, yet the Exposure Draft does not provide any empirical findings on how directors abandon companies and the extent of such abandonment in reality. Moreover, the appointment of liquidator administratively was said to assist as an additional mechanism to aid in addressing possible phoenix activities. The Explanatory Draft fails to consider the Assetless Administration Fund (**AAF**), which is an existing remedy that allows liquidators to prepare a report to ASIC where an investigation into the company's affairs has been completed where that company has a few or no assets.

Thus, empirical evidence on company abandonment is important because one should not be changing laws unless the current one is proven to be defective or deficient in some ways. In addition, the Explanatory Draft is proposing a new law which equates to what AAF offers. Baxt has previously commented on the non-usefulness of proposing law reform when the existing laws have yet to be fully tested in courts[1]. That is, the existing law may be opened to other legal interpretations and thus may have a different impact in the shaping of legal remedies if used properly. The existing regulatory and legal options need to be fully exhausted first before advocating for law reform.

Furthermore, the proposed subsection 489F(3) appears to allow ASIC to act contradictory in nature. That is, the proposed subsection allows ASIC to reinstate a company then to wind it up subsequently. This kind of provision may cause the

[1] Presentation from Baxt, R, *Market Integrity Conference*, Sydney, October 2009. Also see Baxt, R, "Encouraging entrepreneurialism: What parts do/ should the courts play?" (2008) 36 *Australian Business Law Review* 62-64.

regulator the ability to allow its decision-makers to wrongfully reinstate a company without any consequences (because ASIC has the power to subsequently initiate administrative winding up procedures without court supervision). ASIC, as a regulator, should always be made accountable for its decision-making, and hence, laws which allow ASIC to act without consequence should not be allowed to exist. For the reason outlined here, subsection 489F(3) does not contain good accountability measure as it is currently drafted.

Currently, the Corporations Act has existing provisions that allow winding up proceedings to be initiated by ASIC in order to appoint a provisional liquidator. This is pursuant to ss 459A, 459B, 464 and 472 of the Corporations Act. In lieu of adding s 489F into the Corporations Act, this paper will advocate the law reform to take place in the form of amending ss 459A and 459P of the Corporations Act. This will require court intervention, which ensures ASIC's intervention into private business affairs to only occur when it has evidence to show that fraudulent phoenix activities has taken place.

Section 459P of the Corporations Act: Winding Up Phoenix Activities

There has been criticism made on the lack of formal winding up procedures in situations where phoenix activities are detected[2]. Though currently, there is s 459P of the Corporations Act that stipulates winding up proceedings, it is insufficiently specific in addressing phoenix activities when detected by regulators, liquidators or creditors. This paper advocates that there should be a statutory provision within the Corporations Act specifically targeting ASIC's ability in taking up the responsibility of initiating a winding up application if it detects a phoenix activity is in play. The current law allows ASIC to pursue with a winding up order where it suspects the company is operating while being insolvent. While this is a practical and effective law thus far, it is insufficient because there is a subtle difference between insolvent trading and phoenix activities despite the two commercial behaviours are closely linked[3].

Currently, s 459A of the Corporations Act states that:

> "**459A Order that insolvent company be wound up in insolvency**
>
> On an application under section 459P, the Court may order than an insolvent company be wound up in insolvency."

Currently, s 459P of the Corporations Act states that:

> "**459P Who may apply for order under section 459A**

[2] See Victoria Law Reform Committee, *Curbing the Phoenix Company- First Report on the Law Relating to Directors and Managers of Insolvent Corporations* (Melbourne: CCH Australia Limited, 1994) at p. 17.
[3] See Australian Securities Commission, *Phoenix Companies and Insolvent Trading: An Australian Securities Commission Research Report* (Sydney: Australian Securities Commission Publication, 1996).

> **(1)** **[Who may apply for winding up order]** Any one or more of the following may apply to the Court for a company to be wound up in insolvency:
> (a) the company;
> (b) a creditor (even if the creditor is a secured creditor or is only a contingent or prospective creditor);
> (c) a contributory;
> (d) a director;
> (e) a liquidator or provisional liquidator of the company;
> (f) ASIC;
> (g) a prescribed agency.
>
> **(2)** **[Applicants requiring leave]** An application by any of the following, or by person including any of the following, may only be made with the leave of the Court:
> (a) a person who is a creditor only because of a contingent or prospective debt;
> (b) a contributory;
> (c) a director;
> (d) ASIC.
>
> **(3)** **[Where court may give leave]** The Court may give leave if satisfied that there is a prima facie case that the company is insolvent, but not otherwise.
>
> **(4)** **[Conditional leave]** The Court may give leave subject to conditions.
>
> **(5)** **[Insolvent company]** Except as permitted by this section, a person cannot apply for a company to be wound up in insolvency."

In particular, ASIC should be allowed to initiate a winding up application if it has the evidence to show that the company was dissipating company assets for the purpose of creating a phoenix company. Dissipation of company assets into a related company, or a company where the director has a substantial interest, are all considered as risk factors in identifying phoenix activities[4]. This is especially true when the company director acts in a way that intentionally denies creditors equal access to the company's assets and funds.

To support the idea of making use of winding up applications against phoenix activities, there was a winding up proceedings that was initiated by ASIC, initially not because it was concerned about phoenix activities, but as it turned out, company directors had subsequently attempted to commence phoenix operation after ASIC had initiated the winding up proceedings[5]. As a result of a series of civil proceedings which included not just the winding up proceedings, but also the interlocutory action of refraining directors from engaging in phoenix operation, ASIC had successfully

[4] See Wong, S, "Why is the phoenix activity incorporated into the company strategy?" (2010) 10(7) *Insolvency Law Bulletin* 114-116.
[5] See ASIC Media Release 02/209 *Allied Financial Pty Ltd* dated 12 June 2002.

and proactively stop a phoenix operation from occurring. The implication is that winding up proceedings could be used as a proactive tool in deterring phoenix activities, as opposed to other legal remedies presented to date.

In the case of *ASIC v Tax Returns Australia Dot Com Pty Ltd* [2010] FCA 715 ("**Dot Com case**"), though the company in question is not a phoenix company, but the court in this case was asked to consider issues that are relevant to phoenix activities. The Federal Court was specifically asked to consider if there was any apparent or probable corporate insolvency, if there was a risk of dissipating company's assets, and if there was a public interest in a prompt independent examination of the company's financial records, accounts and transactions. The court found that there was a reasonable prospect that the company be wound up in the future after the provisional liquidators have examined the company's financial books and records, as well as its transactions.

In the Dot Com case, Dodds-Streeton J found that while the company was at a real risk of facing insolvency, asset dissipation did take place. Client monies were specifically used to purchase personal real property. Hence, client monies could not be returned. In addition, tax was not remitted to the ATO. Deriving from these facts, it is reasonable for a person to conclude that had the director in this case decided to commence another company, he would be involved in phoenix activities.

In granting the application to appoint provisional liquidators to examine the company's financial affairs in the Dot Com Case, the court was satisfied that there was a reasonable prospect of a winding up order as well as the company's assets may be at risk of being dissipated. The latter is worthy of investigation because the court appears to be satisfied with the company's assets may be at risk of being dissipated, rather than the real risk of being dissipated. Given this is the interpretation that will be ultimately be used in a winding up order, this interpretation implies that in ensuring phoenix activities do not continue to operate, it is sufficient for ASIC to show that the company's funds or assets may be at risk of being transferred to the phoenix company, rather than showing that the risk is real.

The Dot Com case has the implication in responding to the ruthlessness of those who operate phoenix activities by winding up their companies. Under s 459P of the Corporations Act, winding up application can be pursued if there is a prima facie case that the company is insolvent[6]. As this law currently stands, it includes insolvent trading cases, but excludes cases that involve phoenix activities.

Understandably, the court and the legislature would never intend to shut down companies that are near-insolvent yet it may still have a chance of revival. Under public policy, it is prudent that the culture of corporate rehabilitation is encouraged wherever possible[7]. However, it is important to distinguish between a company that is genuinely attempting to rehabilitate itself back to its financial health and a company that is carrying out fraudulent phoenix activities in order to avoid all liabilities accumulated by the near-insolvent company. This distinction was emphasised in the Treasury's paper on *Action Against Fraudulent Phoenix Activity: Proposals Paper*

[6] Subsection s 459P(3) of the Corporations Act.
[7] See Parliamentary Joint Committee on Corporations and Financial Services, *Improving Australia's Corporate Insolvency Laws: Issues Paper* (Sydney: PJC Publication, 2003); also see PJC, *Corporate Insolvency Laws: A Stocktake* (Sydney: PJC Publication, 2004).

(**Phoenix Proposals Paper**).

If the wide discretion in appointing provisional liquidators based on the perceived risk, as opposed to real risk, of company assets being dissipated is accepted by the legislature, it would be in line with the discretionary power that has been given to the Australian Taxation Office (**ATO**) by the Treasury in relation to the issue of notice requiring company directors to pay a security bond when they have been suspected by the ATO as phoenix operators. Currently, the ATO is given the discretionary power in relation to taking actions against suspected phoenix activities.

The reality of this would be that, as a revenue-collection agency, the ATO would be seeking security bond at the expense of other creditors' debts still be outstanding and owed by the phoenix company. If the same discretionary power was to apply to ASIC in winding up proceedings, then it would have the capability of shutting down phoenix companies before it can incur further debts, which may include debts owed to the ATO or any other future liabilities that would be owed to the ATO. The need for balancing discretionary powers between the ATO and ASIC may be best achieved by giving ASIC the same level of discretionary powers in initiating winding up proceedings.

If the law allows ASIC to initiate winding up applications against companies that have been suspected of being phoenix companies, this would be most effective in deterring such fraudulent act in a proactive way. Just like the routine winding up application, the onus of proving that the company is running a phoenix scheme should lie with ASIC. It is ASIC's responsibility to detect, investigate and initiate actions in court on behalf of the public. In order to complement the argument that has been put forward in this paper, s 459A of the Corporations Act should be amended as follows:

> "***459A Order that insolvent company and phoenix company be wound up in insolvency***
>
> *On application under section 459P, the Court may order that an insolvent company be wound up in insolvency or a phoenix company be wound up.*"

By adding the phrase '*or a phoenix company*', it widens the operation of winding up procedures under s 459A of the Corporations Act. That is, the eligible person would be able to wind up either an insolvent company or a phoenix company. Furthermore, in order to complement the amendment made in s 459A of the Corporations Act, subsections 459P (1) and (2) should also be amended accordingly as follows:

> "***459P Who may apply for order under section 459A***
>
> ***(1) [Who may apply for winding up order]*** *Any one or more of the following may apply to the Court for a company to be wound up in insolvency or if a phoenix activity has occurred:*
> *(a) the company;*
> *(b) a creditor (even if the creditor is a secured creditor, an unsecured creditor or is only a contingent or prospective creditor);*
> *(c) a contributory;*

(d) a director;
(e) a liquidator or provisional liquidator of the company;
(f) ASIC;
(g) a prescribed agency.

(2) [Applicant requiring leave] *An application by any of the following, or by persons including any of the following, may only be made without the leave of the Court:*
(a) a person who is a creditor or an unsecured creditor only because of a contingent or prospective debt;
(b) a contributory;
(c) a director;
(d) ASIC."

(proposed ss 459A and 459P of the Corporations Act collectively as the **Phoenix Wind-Up Proposal**)

The addition of the unsecured creditor as one of the eligible persons under s 459P of the Corporations Act is necessary in order to provide the best possible protection to consumers in the Australian market place. The best possible consumer protection means to provide legal remedies for those who do not fall under any categories currently listed under the current s 459P of the Corporations Act. Consumers such as creditors would then be able to take more control of the winding up proceeding by initiating private actions against the company that was engaged in phoenix activities.

Unsecured creditors are often ones that suffer from the operation of phoenix activities[8]. By allowing an unsecured creditor the standing to initiate a winding up proceedings against a phoenix company, it will provide some forms of protection to their rights. Furthermore, to prevent anyone from claiming standing when their interests are not adversely affected by the phoenix company in question, subsection 459P(2) of the Corporations Act under the Phoenix Wind-Up Proposal requires unsecured creditor to apply for leave. Courts will then decide on whether the applicant is a true unsecured creditor for the purpose of initiating a winding up proceeding based on evidence submitted. Moreover, it provides unsecured creditors the ability to gain access to company's residual assets without upsetting the order of priority in creditor payments.

Section 601AH of the Corporations Act: Reinstatement

The Phoenix Wind-Up Proposal is most useful if ASIC could successfully reinstate a deregistered company when it suspects the deregistered company was used to facilitate fraudulent phoenix activities. A successful reinstatement may lead to ASIC taking further actions against company directors relating to their duties and obligations as directors, which may be a variety of enforcement actions such as director's duties, or duties to prevent the company from insolvent trading, or any other forms of misleading or deceptive conducts. Apart from ASIC pursuing further enforcement actions against the company director, liquidators and creditors may also pursue further civil actions against the reinstated company and its directors.

[8] See Wong, S, "Why is the phoenix activity incorporated into the company strategy?" (2010) 10(7) *Insolvency Law Bulletin* 114-116.

Thus, both the regulator and the public are able to enforce a form of action against those who are responsible for conducting phoenix activities and causing economic injuries to the public. The current Exposure Draft proposes to repeal subsection 601AH(3) of the Corporations Act. In lieu of repealing the subsection, this paper will advocate for law reform in subsections 601AH(1) and (2) of the Corporations Act.

Consequences of phoenix activities often involve company director starting a new company without repaying debts incurred in the previous company. Creditors could not reclaim debts from the previous company that were owed to them because it has been deregistered. In combating this phenomenon, creditors should be encouraged to make applications to the court for reinstating deregistered companies under s 601AH of the Corporations Act if they suspect the company director has the financial capacity to pay for their liabilities. A reinstatement of a company will allow a deregistered company to become operational again. The reinstatement of the deregistered company can be done through court's approval. Ultimately, the court has the discretion in deciding whether a company should be reinstated or not. Usually, applicants of reinstatement would write to ASIC seeking no objection. Furthermore, ASIC can also seek court's approval in reinstating the deregistered company.

Under s 601AH of the Corporations Act, ASIC, liquidators and creditors all have standing in making such an application to courts. In fact, research has advocated that creditors should be encouraged to reinstate a company that could be proven to be the predecessor of the phoenix company[9]. However, research to date showed that no application has ever been filed under s 601AH of the Corporations Act in order to reinstate a company that has been suspected of conducting phoenix activities. There are two implications, that is, either liquidators or creditors knew reinstatement would not be able to assist with debt repayment as the deregistered company no longer has assets; or s 601AH is not sufficiently clear in relation to its remedies against phoenix activities.

Before a company can be turned into a new phoenix company, the company director winds up the former company or deregister it. The possible improvement in winding up proceeding has already been canvassed in the Phoenix Wind-Up Proposal discussions. Australian research has called for improvements in the procedures of company deregistration in order to curb phoenix activities[10]. The Attorney-General's Department, Simplification Task Force (**STF**) proposed the *Second Corporate Law Simplification Bill 1996* (Cth) (**Simplification Bill**) which supported the practice of ASIC been allowed to initiate deregistration proceedings against companies[11]. The

[9] See Wong, S, "The prominence of phoenix activities in Australia" (2008) 9(4) *Insolvency Law Bulletin* 63-66; Wong, S "Corporate rescue in Australia and the United States: A comparative study" (2009) 18(5) *Journal of Bankruptcy Law and Practice* 547-576; and Wong, S, *Submission to the Treasury: Comments Addressing Question 15 of the Action Against Fraudulent Phoenix Activity Proposals Paper November 2009*, dated 14 January 2010.

[10] See Tomasic, R, "Developments and events: Phoenix companies and corporate regulatory challenges" (1996) 6 *Australian Journal of Corporate Law* 461-465; also see Attorney-General's Department, Simplification Task Force, *Officers and Related Party Transactions* (Canberra: Attorney-General's Department Publication, 1995) at pp. 8-9.

[11] See STF, *Officers and Related Party Transactions* (Canberra: Attorney-General's Department Publication, 1995) at pp. 8-9; also see ss 601AA-601AH of the Simplification Bill.

initiation of deregistration proceedings is, in effect, may cause the reinstated company be liable for previous or immediate future debts.

By the same analogy, ASIC should also be allowed to initiate reinstatement proceedings if it suspects that the deregistered company was involved in phoenix activities, and such reinstatement would assist with derivative actions that could be initiated by liquidators, creditors, or further actions could be brought forward by ASIC. The paper advocates that the onus is to fall on ASIC because without a strong ground in proving that the person is carrying phoenix activities or is contemplating or planning phoenix activities, the regulator should not be able to reinstate corporations as the reinstatement proceedings will incur further debts for the subject of reinstatement.

Phoenix activities are created through the resurrection of insolvent companies. By using the same analogy, creditors could seek to resurrect insolvent companies in order to bring actions against the insolvent companies and their directors. Currently s 601AH of the Corporations Act reads as follows:

> "**601AH Reinstatement**
>
> *Reinstatement by ASIC*
>
> **(1)** ASIC may reinstate the registration of a company if ASIC is satisfied that the company should not have been deregistered.
>
> *Reinstatement by Court*
>
> **(2)** Court may make an order that ASIC reinstate the registration of a company if:
> (a) an application for reinstatement is made to the Court by:
> (i) a person aggrieved by the deregistration;
> (ii) a former liquidator of the company; and
> (b) the Court is satisfied that it si just that the company's registration be reinstated.
>
> **(3) [Orders court may make]** If the court makes an order under subsection (2), it may:
> (a) validate anything done between the deregistration of the company and its reinstatement; and
> (b) make any other order it considers appropriate.

Note: For example, the Court may direct ASIC to transfer to another person property vested in ASIC under subsection 601AD(2).

> *ASIC to give notice of reinstatement*
>
> **(4)** ASIC must give notice of a reinstatement in the *Gazette*. If ASIC exercises its power under subsection (1) in response to an application by a person, ASIC must also give notice of the reinstatement to the applicant.

Effect of reinstatement

(5) If a company is reinstated, the company is taken to have continued in existence as if it had not been deregistered. A person who was a director of the company immediately before deregistration becomes a director again as from the time when ASIC or the Court reinstates the company. Any property of the company that is still vested in the Commonwealth or ASIC revests in the company. If the company held particular property subject to a security or other interest or claim, the company takes the property subject to that interest or claim."

If s 601AH of the Corporations Act could be modified so one of the grounds for reinstating the company is that the company could be proven to be the predecessor of the phoenix scheme, creditors would be offered the option of combating this phenomenon by reinstating these insolvent companies and seeking debts that were owed to them by making reinstated company liable for the debts, independent of the regulator's intervention. The law reform proposal relating to reinstating the predecessor of a phoenix company should embody the element of court's involvement in adjudicating the action of the company director.

Given the above argument, the paper proposes the following amendments to the current s 601AH of the Corporations Act for the purpose of widening ASIC's power in investigating company directors who engage in phoenix activities and to assist those who are aggrieved by directors of phoenix companies:

"***601AH Reinstatement***

Reinstatement by ASIC

(1) *ASIC may reinstate the registration of a company if ASIC is satisfied that the company should not have been deregistered.*
(2) *ASIC may reinstate the registration of a company if ASIC can prove that the deregistered company was deregistered solely for the purpose of creating a phoenix activity.*" (**Reinstatement of Phoenix Predecessor Proposal**)

The Reinstatement of Phoenix Predecessor Proposal has two purposes. First, it provides ASIC the power to investigate and prosecute individuals who are responsible for carrying out phoenix activities. Once a deregistered company becomes registered company, the company director becomes statutorily liable for this registered company as having the current directorship. ASIC can then prosecute the company director accordingly. The second purpose of the Reinstatement of Phoenix Predecessor Proposal is to provide persons aggrieved by the phoenix activities an opportunity to initiate private proceedings against the predecessor of the phoenix company if ASIC is able to prove the phoenix activity exists and subsequently reinstated the company.

The reason why the paper does not advocate the Reinstatement of Phoenix Predecessor Proposal to apply to subsection 601AH(2) of the Corporations Act is because it would not be a desirable outcome if the court is constantly faced with creditors' claims for reinstating the predecessor of phoenix company. It is the regulator's role to investigate whether or not a phoenix activity has taken place, and not the courts' role to do so. Hence, it is most appropriate that the proposed power of reinstating the predecessor of the phoenix company rests with ASIC.

It is necessary to include the requirement of sole purpose of creating a phoenix activity in the Reinstatement of Phoenix Predecessor Proposal to create a higher burden for ASIC to prove that a deregistered company is, in fact, a predecessor of a phoenix company. A higher burden is required because if the predecessor of a phoenix company was successfully reinstated, then there is a high probability that ASIC would pursue further investigation into the reinstated company and consequently, could lead to criminal prosecution of those who are responsible for making decisions on behalf of the reinstated company.

The Reinstatement of Phoenix Predecessor Proposal acts as a warning to company directors in relation to what is going to happen if they continue to operate their phoenix companies. A prudent company director, upon the receipt of notice of ASIC's intention in applying for a reinstatement under the Reinstatement of Phoenix Predecessor Proposal, would take every reasonable steps to ensure that creditors of the deregistered companies are paid, and at the same time, not to incur further debts with the current company which is alleged by ASIC as a phoenix company. This kind of initiative may prevent ASIC from taking further regulatory actions against the regulated entity. On the contrary, if the company director does not take any steps toward reducing the company debts as described in the previous paragraph, there may be scope for ASIC to escalate the regulatory tool to the next level, namely, the actions available under the Phoenix Wind-Up Proposal.

The Application of the DEFEAT Test to Law Reform Proposals

In order to assess whether the proposals here is expected to be effective in curbing phoenix activities, this paper assesses the Phoenix Wind-Up Proposal and the Reinstatement of Phoenix Predecessor Proposal by examining whether each proposal by asking the following questions:

1. Whether the new law sends out a deterrent message? (**deterrence test**)
2. Whether the new law provides an efficient process? (**efficient test**)
3. Whether the new law provides fairness to all parties affected? (**fairness test**)
4. Whether the new law involves all relevant expertise? (**expertise test**)
5. Whether the new law ensures accountabilities on all parties affected? (**accountability test**)
6. Whether the new law is transparent to the public? (**transparency test**) (collectively as the **DEFEAT Test**)[12]

[12] The DEFEAT Test is created through author's PhD thesis. It is based on the modification of an assessment method stemmed from various legal theories and originally developed by Vanessa Finch in 1997, where Finch used efficiency, fairness, expertise and accountability tests in measuring the effectiveness of insolvency law, see Finch, V, "The measure of insolvency law" (1997) 17(2) *Oxford*

Phoenix Wind-Up Proposal

When applying the deterrence test to the Phoenix Wind-Up Proposal, one would find that despite there is no criminal element in the Phoenix Wind-Up Proposal, it nevertheless sends out a general deterrent message to company directors that if they were to engage in insolvent trading or phoenix activities, their companies may be wound up. The Phoenix Wind-Up Proposal is expected to widen the operation of the current ss 459A and 459P of the Corporations Act and to allow ASIC to capture fraudulent company directors engaging in prohibited conducts. The Phoenix Wind-Up Proposal also aims to set up company directors' expectation with respect to unsecured creditors' rights when engaging in phoenix activities.

With respect to the application of the efficiency test to the Phoenix Wind-Up Proposal, there are two aspects. First, the Phoenix Wind-Up Proposal is effective in allowing those who have standing to initiate winding up proceeding against phoenix companies. The efficiency exists as the Phoenix Wind-Up Proposal widens the current operation of ss 459A and 459P of the Corporations Act in order to capture, not just insolvent trading, but also phoenix activities. The second aspect relates to the hurdle that a creditor must cross in order to seek a winding up order. The Phoenix Wind-Up Proposal, however, cannot offer better efficiency with respect to creditors. This is because under subsection 459P(2) of the Corporations Act, creditors, along with contributory, director and ASIC, may only apply for an order to wind up company in insolvency or carrying out phoenix activity with the leave of the court.

This means subsection 459P(2) of the Corporations Act creates a higher legal hurdle for a genuine creditor to apply for a winding up order. That is, creditors will need to spend more time in court or preparing for court in order to seek a winding up order because creditors do not have automatic standing in initiating such action (as opposed to a liquidator who may apply for a winding up order in the first instance). This subsection, however, is necessary in order to ensure all actions are initiated by person whose interest is genuinely affected by the phoenix activity.

In the application of the fairness test, prima facie, it appears that the Phoenix Wind-Up Proposal is unfair to creditors because creditors will need to jump a higher legal hurdle in order to seek a winding up order. However, as discussed earlier, this hurdle is a necessity to have in order to exclude applications that are not genuine in nature. Furthermore, it is not uncommon that courts have a role to play in determining whether the applicant has a standing or not. For example, the status of eligible applicant for the purpose of public examination under ss 596A and 596B of the Corporations Act is also granted by court after hearing evidence relating to the applicant's standing. Thus, in order to ensure fairness to all stakeholders involved in the winding up proceedings, it is necessary to require certain categories of applicants to apply to court for leave.

Journal of Legal Studies 227-251. The author modified Finch's test by adding deterrence and transparency tests to the existing four tests.

The Phoenix Wind-Up Proposal does pass the expertise test by offering interested parties the opportunity to wind up an insolvent or a phoenix company. The expertise test aims to measure if the insolvency process involves individuals with the relevant expertise. Furthermore, Tomasic has suggested that creditors' knowledge about company directors' businesses could be used as a method of preventing phoenix activities from occurring[13]. Tomasic further suggested that an independent insolvency expert would be required to conduct the above process without being persuaded or influenced by creditors[14].

Putting aside the winding up proceeding within the Phoenix Wind-Up Proposal, this proposed law reform does allow experts such as liquidators, provisional liquidators, ASIC, creditors and as a proposed addition, unsecured creditors, to offer their reasons for winding up phoenix companies. Creditors' knowledge could be incorporated into the winding up process and to prevent directors from entering into an external administration that would only benefit the company management.

Furthermore, the *United Nations Commission on International Trade Law Legislative Guide on Insolvency Law 2004* (**UNCITRAL Legislative Guide**) emphasised that corporate rescue plan should aim to facilitate negotiations between all parties (i.e. company directors, secured and unsecured creditors, employees and shareholders). In addition, corporate rescue regime should also aim to obtain consensus from all parties and to promote equal bargaining power between all affected parties.

Liquidators and regulator have the relevant professional skills in detecting, investigating and hence concluding that phoenix activities have taken place. Company directors and creditors can also be considered as experts because they often possess detailed knowledge of a company's day-to-day operations, processes of business transactions and exclusive company dealings[15]. In addition, the Phoenix Wind-Up Proposal may also give company directors the opportunity to wind up their companies if they suspect their co-directors are engaging in phoenix activities as company directors are also allowed to make applications for winding up orders without leave from the court. Hence, the Phoenix Wind-Up Proposal does satisfy the expertise test.

There is accountability in the Phoenix Wind-Up Proposal. The reason being that it gives liquidators and regulators the power to wind up phoenix companies after detecting phoenix activities are in play. If the liquidator winds up the phoenix company in a timely manner, then there will be more hope for creditors to gain access to debts that were owed to them after the liquidation process has been completed. If ASIC winds up a phoenix company as soon as it is detected, then it offers more protection to the general public because it is able to prevent further economic injury to the society. Similarly, as ATO falls under the category of prescribed agency, it will also be able to wind up phoenix companies under the Phoenix Wind-Up Proposal.

[13] See Tomasic, "Creditor participation in insolvency proceedings- towards the adoption of international standards" (2006) 14 *Insolvency Law Journal* 173-187.
[14] See Tomasic, "Creditor participation in insolvency proceedings- towards the adoption of international standards" (2006) 14 *Insolvency Law Journal* 173-187.
[15] See Finch, V, "The measure of insolvency law' (1997) 17(2) *Oxford Journal of Legal Studies* 227-251.

Lastly, the Phoenix Wind-Up Proposal does offer a transparent process. It specifically states the identities of eligible applicants in seeking court orders to wind up phoenix companies. It also specifies who would be requiring leave from the court prior to making applications to wind up a phoenix company. In addition, the Phoenix Wind-Up Proposal also clearly states the consequence for carrying on business with a phoenix company if it is detected by interested parties (i.e. regulators, liquidators and creditors). The clear articulation of the consequence of carrying on business with a phoenix company ties in with general deterrence. As mentioned earlier, the Phoenix Wind-Up Proposal does offer general deterrent effect to the public because it is transparent in terms of company directors' expectation of consequences associated with operating phoenix companies.

Reinstatement of Phoenix Predecessor Proposal

In the application of the deterrence test to the Reinstatement of Phoenix Predecessor Proposal, it is reasonable to state that it does have a general deterrent effect on company directors who are considering engaging in phoenix activities to avoid their obligations to company creditors. The Reinstatement of Phoenix Predecessor Proposal offers ASIC wider investigative and prosecutorial powers in relation to phoenix activities.

In applying the efficiency test to the Reinstatement of Phoenix Predecessor Proposal, one would find that it provides efficiency in dealing with all interested parties. Under the Reinstatement of Phoenix Predecessor Proposal, ASIC is able to reinstate the relevant company as soon as it detects that a phoenix activity has taken place and subsequently prosecutes the relevant person who is responsible in deregistering the company in the first place. This efficiency not only provides ASIC with greater power in curbing phoenix activities, it also prevents further economic injuries to the Australian market place because ASIC would have stopped a particular phoenix activity to continue to operate.

Apart from providing more efficiency to ASIC's investigation and prosecution of directors who are responsible for carrying out phoenix activities, the Reinstatement of Phoenix Predecessor Proposal also provides an efficient process for creditors, liquidators or any individuals who are aggrieved by the relevant phoenix activity to initiate their private actions, after ASIC had successfully reinstate the predecessor of the phoenix company, to claim what they have lost financially as a result of dealing with the reinstated company or the phoenix company.

The Reinstatement of Phoenix Predecessor Proposal does address the fairness question appropriately. It does so by using court as the decision-maker. The court decides, based on the evidence before it, on whether a phoenix activity has taken place. If the court decides that a phoenix activity has taken place, then the court will order the predecessor of the phoenix company be reinstated. By having court's supervision in place, there is less danger of ASIC reinstating companies at its discretion and being biased against the company director it has investigated.

In addition, ASIC needs to prove that the sole purpose of the company deregistration was to create a phoenix activity. The sole purpose test will ensure that ASIC only brings cases of reinstatement to the court only if it has a reasonable prospect of

success. Furthermore, the Reinstatement of Phoenix Predecessor Proposal also provides fairness to both the creditor and the company director a fair forum, the court, in assessing whether the creditor's claim is valid after the relevant company has been reinstated by ASIC. That is, the Reinstatement of Phoenix Predecessor Proposal aims to ensure that there is no overprotection of creditors.

In the application of the expertise test, the Reinstatement of Phoenix Predecessor Proposal does offer an appropriate forum for all relevant experts to participate in the process of reinstating a company that is suspected to be the predecessor of a phoenix company. The appropriate forum is the court. The relevant experts that are expected to participate in the reinstatement process include ASIC, liquidators, creditors and company directors. ASIC offers its findings relating to the phoenix company from its investigation, and to some extents, liquidators may also do the same. Creditors offer their evidence in relation to debts that were owed to them and company directors, with their intimate knowledge about their own companies, would have the opportunity to defend their own claims.

In applying the accountability test to the Reinstatement of Phoenix Predecessor Proposal, there is much reliance placed on courts and ASIC to ensure phoenix activities are captured through this proposal. The Reinstatement of Phoenix Predecessor Proposal allows the court to make a final decision about whether or not, based on the evidence submitted by ASIC and the rebutting evidence from the director of the deregistered company, that the deregistered company was deregistered for the sole purpose of creating a phoenix activity.

Lastly, there is a high level of transparency with respect to the intention behind the Reinstatement of Phoenix Predecessor Proposal. From the company director's perspective, the Reinstatement of Phoenix Predecessor Proposal is a method of disabling phoenix activities from taking place when detected by the regulator. Such detection is expected to lead to other forms of liabilities under the proposed Phoenix Activity Prohibition Proposal. From ASIC's perspective, the Reinstatement of Phoenix Predecessor Proposal could allow ASIC to reinstate a deregistered company if its investigation shows that it is deregistered for the sole purpose of creating phoenix activities. It, however, creates an extra burden for ASIC to reinstate a deregistered company. The Reinstatement of Phoenix Predecessor Proposal is able to remind ASIC that the high burden of proof in proving that a phoenix activity must exist in order for the court to approve this kind of reinstatement. It also offers transparency to directors of the reinstated company as it flags ASIC's intention of conducting further investigation into the company's affairs which caused the corporate collapse.

Overall, the Phoenix Wind-Up Proposal and the Reinstatement of Phoenix Predecessor Proposal are able to answer to the questions posed under the DEFEAT test. Though there were discussions in relation to whether creditors would be treated fairly under the efficiency test and fairness test under the Phoenix Wind-Up Proposal, the analysis above shown that it is necessary to add an extra legal hurdle for creditors in order to distinguish between genuine applications from those that are initiated for reasons other than winding up an insolvent or a phoenix company. It is necessary to re-apply the DEFEAT test again on the Phoenix Wind-Up Proposal and the

Reinstatement of Phoenix Predecessor Proposal if these laws are to be accepted into the Corporations Act as amendments to see how they operate in practice.