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Mr James Mason
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

**By Email: phoenixing@treasury.gov.au**

Dear Mr Mason

## Combatting Illegal Phoenixing

Thank you for the opportunity to lodge a submission on the range of law reform proposals (set out in the Consultation Paper "Combatting Illegal Phoenixing") which have the aim of deterring and disrupting illegal phoenix activity.

The Consultation Paper is quite comprehensive and demonstrates the level of commitment that Government places on combatting illegal phoenix activity.

In making this submission, we have had the opportunity of reviewing in advance the draft submission prepared by the Australian Restructuring Insolvency & Turnaround Association ("ARITA"). With limited resources to devote to preparing a comprehensive submission, we have largely relied on ARITA's submission and we acknowledge and thank ARITA for their efforts and hard work in preparing its submission on behalf of the profession. Without this work we may not have been in a position to participate in the consultation process.

We are generally supportive of ARITA's recommendations so we have only commented where we have views in addition to those already espoused by ARITA. Our ratings provided throughout this paper are our own.

A general observation in relation to phoenix activity is that, in order for any reform or for that matter existing legislation to be successful, it is imperative that the relevant government agencies and insolvency practitioners are adequately funded to investigate, report and prosecute these matters. The prevalence of phoenix activity has been, in our view, largely due to pre-insolvency advisors marketing on the back of "ASIC won't do anything" (due to lack of funding and resourcing) and insolvency practitioners having no access to funding either directly from company assets or externally from government agencies, creditors or other stakeholders. Without addressing this issue any reform will be no more effective than existing legislation and will only allow phoenix activity and pre-insolvency advisors to continue to have a significant detrimental impact on the broader economy.

KRESTON

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As highlighted by ARITA, the key points are as follows:

- There already exist a variety of laws and penalties for transactions, acts and omissions which either constitute or facilitate illegal phoenix activity. Rather than creating new laws, the present laws need enforcement and stiffer penalties.

- There is already a system for designating 'high risk' operators of companies: the disqualification regime in Part 2D.6 of the *Corporations Act 2001* (Cth) ("Act"). That regime should be enforced more rigorously to disqualify high risk individuals from managing corporations.

- Registered liquidators are part of the solution to addressing illegal phoenix activity. Apart from the many statutory reports they provide to ASIC which identify misconduct, which generally are not acted upon, liquidators are often hampered by inadequate funding and a lack of documentary evidence (by reason of breaches of laws relating to books and records) which means that phoenix activity often passes unchallenged.

- We support the introduction of an administrative recovery notice regime in corporate liquidations (similar to the present Section 139ZQ of the *Bankruptcy Act 1966* (Cth) ("Bankruptcy Act"), which will provide a more expedient and cost-effective manner of pursuing voidable transactions, including those transactions which reflect illegal phoenix activity (e.g. uncommercial transactions).

- We support measures to prevent miscreant directors abandoning companies or 'gaming the system' by backdating resignation notices. We support attaching the responsibility for notification of resignation of directorships to the directors themselves rather than merely the company concerned.

- A cab rank or 'roster' system for the appointment of external administrators was rejected by the *Harmer Report* and is fraught with issues of practicality, timeliness and cost. A cab rank appointment system is an anti-competitive measure which sits in tension with recent law reforms introduced by the *Insolvency Law Reform Act 2016* (Cth) ("ILRA") enhancing the rights of creditors to replace external administrators appointed under a voluntary system.

- We support the limited exclusion of related creditor voting rights on resolutions for the removal and replacement of an external administrator, which will ensure the new and improved ILRA rights of creditors to replace external administrators work better and as intended.

- We do not support of the notion of a Government liquidator to conduct external administrations. The existing profession of private, registered liquidators are better placed – in terms of efficiency, competence, expertise and costs – to conduct external administrations. A Government liquidator would also confront complications borne from the fact that the Commonwealth Government is often a major creditor in external administrations.

- Rather than creating new administrative (recurring) expenditure through a cab rank system or Government liquidator, Government funding and resources should be devoted to enforcement of present laws and providing liquidators of assetless companies with the funding required to pursue illegal phoenix activity.

- We are concerned by proposals which seek to elevate the pre-liquidation rights and status of Government creditors (principally the Australian Taxation Office) above those enjoyed by other general unsecured creditors.

Yours faithfully

| Tràcy Knight | Katherine Barnet | Hugh Armenis | Damien Lau |
|---|---|---|---|
| Partner | Partner | Partner | Director |
| **Registered Liquidator** | **Registered Liquidator** | **Registered Liquidator** | **Registered Liquidator** |

# About Bentleys

Bentleys is a full service national network of accounting, tax, advisory, audit and corporate recovery specialists. Bentleys has over 80 partners and 600 professional staff with offices located in all major capital cities.

Bentleys Corporate Recovery comprises five dedicated partners and directors who are supported by over 30 corporate recovery professional staff members. Our partners and directors are registered Liquidators, members of the Institute of Chartered Accountants, members of ARITA and are experienced industry professionals. Partners of Bentleys Corporate Recovery hold positions on the ARITA National and State Boards, CAANZ Ethical Committee, ASIC liaison committee and various corporate boards.

We have a broad range of experience in all forms of Insolvency engagements, such as Liquidations (e.g. New Cap, Octaviar, Keystone Group of Companies), Voluntary Administrations (e.g. Queenspark Retail Stores, Kimberley Diamond Mines, Skytrans Airline) and Receiverships.

# 1 Broad Reforms

## 1.1 A Phoenix Hotline

1. ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

   **Rating: 2**

2. *Are there any other reporting mechanisms which you think would assist people to report suspected illegal phoenix activity?*

   We agree with ARITA's submission, however, emphasise that it is critical that the information collated and shared amongst agencies is acted upon.

3. *What are the benefits and risks of a 'phoenix hotline'?*

   We agree with ARITA's submission.

4. *Which agency do you believe would be best placed to operate such a hotline?*

   ASIC is the logical agency. Any hotline needs to be backed by a willingness to aggressively pursue and prosecute phoenix behaviour.

5. *What public reporting would be appropriate to ensure transparency? What other mechanism could be considered?*

   We agree with ARITA's submission. The statistics reported need to show reports received and action commenced as a result of those reports. In due course, a reporting of outcomes arising from those actions should be reported, including what the offence was, who the offender was and the penalty awarded.

## 1.2 A Phoenixing Offence

6. ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

**Rating: 8**

We agree with ARITA's comments in that there is little utility or merit in the creation of a new 'phoenixing offence' provision when there are already existing provisions available.

We also strongly support the notion of introducing an administrative recovery notice mechanism for liquidations, similar to that which presently exists in bankruptcy under s 139ZQ of the *Bankruptcy Act*. We consider that this will provide a more cost-effective

and expedient process for liquidators to pursue obvious and actionable phoenix transactions under the existing law.

7. *What are the benefits and risks of this approach?*

Again, we see little benefit in the new 'phoenix offence' but agree there are significant advantages in providing for an administrative recovery notice regime.

8. *Should ASIC retain control of the issuing of such notices to ensure that they are not issued inappropriately?*

We agree with ARITA's comments in that we do not see why ASIC need retain control of the issuing of administrative recovery notices. Registered liquidators, as regulated professionals, are well placed to appropriately utilise any new power to issue administrative notices to recover compensation or property resulting from illegal phoenix transactions (such as uncommercial transactions).

9. *Are there other regulators who should also be able to issue such notices (for example the Fair Entitlement Guarantee Recovery Program)?*

We agree with ARITA's comments. The right to conduct such recovery action should not be vested in individual creditors but should remain a matter of power and judgment of the liquidator (the liquidator being the officer and fiduciary charged with the conduct of the winding up in the interests of creditors as a whole). Active and engaged creditors can, as always, opt to support or fund a liquidator to take whatever action may be open to pursue voidable transactions.

10. *Should liquidators have the ability to independently issue such notices in cases where they suspect that illegal phoenixing has taken place?*

See our submission above in respect of Question No. 8.

11. *How long should the law allow for the recipient to respond?*

We agree with ARITA's comments in this regard.

12. *What course of action should be pursued where the recipient fails to comply with a notice?*

We agree with ARITA's comments in this regard.

13. *What are the some of the challenges ASIC is likely to face in seeking compliance with the notice?*

In addition to ARITA's comments is the challenge that the notice will simply be ignored.

14. *Do you think that such an arrangement will reduce the cost of taking recovery action or seeking compensation for the loss suffered?*

We agree with ARITA's comments and would expect that such an arrangement would streamline proceedings and simplify costs.

15. *Are there safeguards which should be implemented in respect of the proposal?*

We agree with ARITA's comments that the ability of a recipient to apply to Court to set aside a notice is, in our view, a sufficient safeguard.

16. *If such a provision were to be introduced, should any of the existing voidable transaction provisions be amended or repealed?*

We agree with ARITA's comments that the notion of an administrative recovery notice regime would appear to complement all existing voidable transactions provisions. Therefore, we do not see any argument or reason for any such amendments or repeals.

17. *Are these remedies appropriate? Are there further remedies or penalties we should consider?*

18. *If the above amendments are made, should the law also be amended to include a specific provision to the effect that knowing involvement in a contravention of the provision will itself constitute a contravention of the provision (as per sections 181 — 183 of the Act)?*

19. *What tests can be applied to determine if a person has been involved in the facilitation of illegal phoenix activity?*

We agree with ARITA's comments in this regard. Rather than creating new provisions and remedies which largely repeat or mirror existing ones, it is breaches of the existing laws which need to be sanctioned. Any new 'phoenix offence', like existing laws, will only be effective if there is enforcement and action, whether by regulators or by liquidators funded and supported by Government.

**20. *On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 2

21. *Which existing breaches of the law, if any, should be designated as phoenix offences?*

We agree with ARITA's submission.

## 1.3 Addressing issues with directorships

**22.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 10

23. *Do you agree that there should be a rebuttable presumption that a director should still be held responsible for misconduct if the required notice is not lodged with ASIC in a timely way?*

We agree with ARITA's submission.

24. *What are the benefits and risks of this approach?*

We agree with ARITA's submission.

25. *What is a reasonable period to allow for the requisite notice to be lodged with ASIC?*

We agree with ARITA's submission.

26. *Should the onus for reporting to ASIC be placed on the individual director, rather than the company? If so, would this constitute a significant compliance burden?*

We agree with ARITA's submission.

27. *How should the above measure be enforced? For example, by application to court or ASIC taking other administrative action?*

We agree with ARITA's submission.

**28.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 10

29. *Should sole directors be able to resign without appointing a liquidator or deregistering the company?*

We agree with ARITA's view that this should not be permissible. We are of the view before a sole director can resign they should take steps to find a suitable replacement, liquidate or deregister the company depending on the circumstances.

30. *What are the benefits and risks of this approach?*

We agree with ARITA's submission that there is no identifiable risk but a clear benefit – namely, limiting the proliferation of 'zombie' companies and their potential use in perpetrating phoenix activity.

31. *Should abandoning a company instead be an offence?*

We agree with ARITA's submission that the law should prevent the resignation of a sole director taking effect unless the director has first either arranged for the appointment of a replacement director, appointment of a liquidator, or deregistration (deregistration would of course require the usual declaration from the director as to the company's assets and liabilities).

32. *Should a company with no director for a prescribed period be automatically deregistered? If so, what would be an appropriate period before deregistration should commence?*

We agree with ARITA's submission.

33. *What other options are available for consideration?*

We have no other submission to make on this point.

## 1.4 Restrictions on voting rights

**34. *On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

**Rating: 10** [insofar as the proposed restriction on voting rights of related party creditors is limited to resolutions for the proposed removal and replacement of an external administrator (and to the extent that a liquidator is aware of – or able to verify – a creditor's 'related' status)].

35. *What are the benefits and risks of this approach?*

We agree with ARITA's submission.

36. *Is the current definition of "related creditor" too broad for this purpose? If so, how should "related creditor' be defined?*

We agree with ARITA's submission in that the definition of 'related creditor', presumably that which is set out in s 75-41(4) of Schedule 2 to the Act, incorporates the definition of 'related entity' in s 5 of the *Bankruptcy Act*. That definition does not appear to be unduly broad and captures the range of related parties whose votes, we submit, should be excluded from any resolution dealing with the removal and replacement of an external administrator appointed by directors of a company.

37. *Should related creditors that were company employees be subjected to a different treatment than, say, if they were directors? Why or why not?*

We agree with ARITA's submission.

38. *What level of evidence should be imposed on related creditors to substantiate their respective debts?*

We agree with ARITA's submission.

39. *Should restrictions on related creditor voting be extended to all resolutions proposed in an external administration? Why or why not?*

We agree with ARITA's submission.

40. *Will limiting related creditor voting participation in a creditors' meeting add additional complexities to proceedings? For example quorum requirements in order to validly hold a creditors' meeting.*

We agree with ARITA's submission.

41. *Should the above rule apply to a particular size or type of external administrations or liquidations?*

We agree with ARITA's submission.

42. *Should the court have the power to overturn this restriction?*

We agree with ARITA's submission.

43. *Should this restriction only be applied to certain types of companies, for example small proprietary companies?*

We agree with ARITA's submission.

44. *Are there circumstances where this restriction should not apply?*

We agree with ARITA's submission.

45. *What are some of the ways a related creditor might attempt to circumvent the above measure?*

We agree with ARITA's submission.

46. *What other measures could be considered to avoid collusion between liquidators and related creditors?*

We agree with ARITA's submission.

## 1.5 Promoter penalties

**47.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 1

48. *Should the promoter penalty laws be expanded to apply to promoters or facilitators of illegal phoenix activity?*

We agree with ARITA's submission.

49. *What are the benefits and risks of this approach?*

See above.

50. *If the promoter penalty laws are expanded to illegal phoenix activity, how would they best be structured? For example by adding a new limb to the existing provisions or creating a separate new provision?*

We agree with ARITA's submission.

51. *Are there additional safeguards that would be needed to ensure innocent advisers are not caught by the provisions? Should the adviser have to corroborate that they acted as mere adviser and not as a promoter?*

New law is not necessary.

52. *If promoter penalties are expanded to apply to promoters of illegal phoenix activity, do the existing sanctions provide sufficient deterrent?*

New law is not necessary.

53. *Are the offences of civil penalty and criminal prosecution available under section 202 the Superannuation Industry (Supervision) ACT 1993 preferred to the promoter penalty options above?*

New law is not necessary.

54. *An alternative approach to stop the promotion or facilitation of illegal phoenix activity may be a Court order to require specific performance of some action, for example, submitting a company liquidation proposal for consideration by ASIC. Is there merit in this or alternate approaches to effectively deter those who promote or facilitate illegal phoenix activity?*

New law is not necessary. We agree with ARITA's further comments in this regard.

## 1.6 Extending the Director Penalty Notice regime to GST

**55.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 10

56. *What are the benefits and risks of this approach?*

We agree with ARITA's submission.

57. *Should the DPN regime be expanded to cover GST for all directors, or be restricted to those identified as High Risk Phoenix Operators (see Part Two)?*

We agree with ARITA's submission that the DPN regime for GST should operate in the same way as the current process.

58. *Are there alternative approaches to securing outstanding payment of GST from companies and their directors?*

We agree with ARITA's submission.

## 1.7 Security Deposits

**59.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 4

60. *What are the benefits and risks of this approach?*

We agree with ARITA's comments.

61. *Would improvements to the garnishee provisions adequately address the proposal to strengthen the effectiveness of the security deposit power?*

We agree with ARITA's submission.

62. *Should the proposal be limited to businesses that have been identified as High Risk Phoenix Operators (see Part Two)?*

We do not agree with the use of a HPRO designation.

63. *Are there concerns or practical issues that would need to be addressed with expanding the garnishee power generally for future tax liabilities?*

We agree with ARITA's submission.

64. *Are there any further concerns if this were achieved through amending the definition of 'tax-related liability' to include the amount of an anticipated future tax liability which is the subject of a security deposit demand?*

We hold the same concerns as discussed at 63.

65. *Are there any issues with the existing garnishee processes that should be considered?*

We agree with ARITA's submission.

66. *Should the Government consider additional measures to prevent circumvention of the provisions by transferring, disposing or encumbering assets where a request is issued?*

We strongly agree with ARITA's comments in this regard.

The Act already provides a range of recovery provisions in the event of liquidation, including for recovery of uncommercial transactions, unreasonable director-related transactions and unfair preferences (which can include taking security for no value).

The ATO needs to proactively pursue recovery of debts to liquidation if necessary.

Reforms need to be made to encourage director compliance with their obligations to provide RATAs and books and records to liquidators, ASIC needs to be more proactive in prosecuting directors for breaches of their duties and funding needs to be provided to liquidators so that they can undertake recovery actions for the benefit of creditors.

There is no point creating new laws – it is better to proactively pursue enforcement and recovery under the laws that are already available.

67. *Should the penalties for not complying with a security deposit request be increased to improve compliance?*

Note the concerns expressed above with regards to the ATO's increasing priority position and the impact that has on ordinary unsecured creditors, particularly small business creditors.

# 2 Dealing with Higher Risk Entities

## 2.1 Targeting higher risk entities

**68.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 2

69. *What are the benefits and risks of this approach?*

We agree with ARITA's submission.

70. *Are the safeguards for designating HRPO sufficient? Can you suggest any alternative safeguards that would still allow for swift preventative action to be taken to prevent phoenix activity from occurring?*

71. *What safeguards would be required to ensure that the measure is appropriately targeted?*

72. *Should the Commissioner of Taxation have a discretion to declare a company of which a HRPO is, or has recently been, an officer to also be a HRPO? Should this be extended to other individuals or entities which are associates of the HRPO?*

73. *Should "associate" be defined or determined administratively?*

Addressing these four questions (70-73) together, we repeat our submission above in respect of Question No. 69

## 2.2 Appointing liquidators on a cab rank basis

### 2.2.1 Option 1: High risk phoenix operators

74. ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 1

We strongly agree with ARITA's submission. However, if a cab rank system was introduced we would expect that there would be restrictions/controls around who should be included on the cab rank panel. We would expect that panel members would need to be a professional member of ARITA and subjected to ARITA's Code of Professional Practice.

75. *Are there alternate measures that would be more effective? If so, please provide an outline of what you think would work*.

We agree with ARITA's submission.

76. *Currently, it is intended that the cab rank be restricted to circumstances where an HRPO is or has recently been an officer of the company*.

77. *Should a cab rank apply to all external administration appointments?*

We strongly agree with ARITA's submission.

78. *Should it be applied more widely, but be limited to specified types of external administration appointments where certain criteria are met? For example:*

- *whether it was a director initiated creditors' voluntary liquidation and/or the appointment of a liquidator following a voluntary administration*
- *industry sector*
- *whether pre-insolvency advice was received*
- *prescribed criteria on the company's financial affairs*
- *when there has been a recent transfer identified for some or all the companies assets*
- *where there has been a change of directors within a prescribed period.*

*If the cab rank applies only to those companies where specified criteria are met what should those criteria be? Please specify your reasons*.

We agree with ARITA's submission.

79. *Who should administer the cab rank and how should it be administered? Please explain your reasoning*.

We agree with ARITA's submission that the practical issues, cost and unintended consequences of a cab rank appointment system will exist regardless of what Government agency might be responsible for administering it.

80. *How do you think such a system should be funded?*

We strongly agree with ARITA's submission. Any cab rank system should not constitute a cost of regulating registered liquidators and therefore should not be recovered from registered liquidators under the new ASIC Industry Funding Model.

On the matter of funding liquidators to conduct basic investigations and reporting, we acknowledge and strongly agree with the statement in the Consultation Paper that the activities of liquidators need to be funded in instances of low or no-asset companies.

### 2.2.2 A Government liquidator

81. ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 1

82. *Should consideration be given to establishing a government liquidator to conduct small-to-medium external administrations? Please provide your reasons.*

We agree with ARITA's submission.

83. *What are the benefits and risks of this approach?*

We repeat our submission above to Question No. 82.

84. *If a government liquidator is created, what external administrations should they conduct? Please provide your reasons.*

We repeat our submission above to Question No. 82.

85. *How do you believe a government liquidator should be funded?*

We repeat our submission above to Question No. 82 and again submit that serious consideration should be given to increasing Government funding of registered liquidators to investigate and pursue remedies for illegal phoenix activity. This is far preferable to appropriating scarce Government resources and funding to the conduct of external administrations.

**The problem is existing liquidators aren't adequately funded.**

## 2.3 Removing the 21-day waiting period for a DPN

**86. *On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

**Rating:** 1

87. *Should the 21 day notice period be removed where a director has been designated as a HRPO?*

We agree with ARITA's submission.

88. *What are the benefits and risks of this approach?*

We agree with ARITA's submission.

89. *Should further safeguards attach to DPNs issued to HRPOs in addition to the existing legal rights and safeguards that currently apply to DPNs?*

See above.

90. *Are there alternative approaches to stop a designated HRPO from disposing of their personal assets once they are aware they are required to pay a director penalty?*

Existing legislation already exists to recover any such transfers in the event of bankruptcy. It is important that a trustee in bankruptcy is funded to undertake such actions.

## 2.4 Providing the ATO with the power to retain refunds

**91.** ***On a scale of one to ten, where one is 'ineffective' and ten is 'highly effective', please rate how well you think this measure will operate to deter and disrupt illegal phoenix activity.***

Rating: 3

92. *Should the ATO's power to retain refunds be broadened in respect of HRPOs who have failed to provide other notifications/lodgements capable of affecting their tax liability?*

We agree with ARITA's submission.

93. *What are the benefits and risks of this approach?*

We agree with ARITA's submission.

94. *Should this proposed power be broadened further where notifications are not yet due but will become due in the next reporting cycle? For example where lodgement of an income tax return by the HRPO is not due for some months but is expected to result in a significant liability, should the ATO be able to retain a refund presently owed?*

We agree with ARITA's submission.