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James Mason
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27 October 2017

By email: phoenixing@treasury.gov.au

Dear Sir

Combatting Illegal Phoenixing – September 2017

Thank you for the opportunity to provide a submission on the range of proposed law reforms to deter and disrupt illegal phoenix activity. This submission supports the submission of the Australian Restructuring Insolvency and Turnaround Association ('ARITA'). We have not repeated ARITAs submission in its entirety but have addressed the questions of particular concern to us.

We make the following general comments:

- A variety of laws and penalties for transactions, acts and omissions which either constitute or facilitate illegal phoenix activity already exist. Rather than creating new laws, the present laws need enforcement and harsher penalties.
- A system for designating 'high risk' operators of companies already exists in the form of the disqualification regime in Part 2D.6 of the Corporations Act 2001 (Cth) ('the Act'). That regime should be enforced more rigorously to disqualify high risk individuals from managing corporations.
- Registered liquidators are part of the solution in addressing illegal phoenix activity. Liquidators provide numerous statutory reports to ASIC which identify misconduct (which unfortunately are largely not acted upon). Liquidators are often hampered by inadequate funding and a lack of documentary evidence (by reason of breaches of laws relating to retention and production of books and records) which means that phoenix activity often passes unchallenged.
- A cab rank or 'roster' system for the appointment of external administrators was rejected by the Harmer Report and is awash 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 see the limited exclusion of related creditor voting rights on resolutions for the removal and replacement of an external administrator as beneficial. This would ensure the new and enhanced ILRA introduced rights of creditors to replace external administrators work better and as intended.
- KordaMentha does not support of the notion of a Government liquidator to conduct external administrations. The existing profession of private, registered liquidators is better placed – in

terms of efficiency, competence, expertise and costs – to conduct external administrations. A Government liquidator would face complications due to the fact that the Commonwealth Government is often a major creditor in external administrations and often the subject of voidable transaction recoveries by liquidators for the benefit of unsecured creditors as a whole.

- Rather than creating new administrative 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.

Broad Reforms

A Phoenix Hotline

Question 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: 4

Question 2:

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

We are unaware of an online mechanism for reporting phoenix activity to ASIC. As the regulator of companies, ASIC is the logical choice for a person to report suspected phoenix activity.

Additional resourcing should be considered to enable more action to be taken in response to reports of director misconduct lodged by registered liquidators. Significant information about phoenix activity, transfers of assets and breaches of director's duties is reported to ASIC by registered liquidators under ss 533, 422 or 438D of the Act.

The number of reports lodged by liquidators is substantial in any one year, however, ASIC published information suggests that less than 2% of reports lodged by liquidators alleging misconduct were acted on by ASIC.

A Phoenixing Offence

Question 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: 7

There is no point in creating a new 'phoenixing offence' provision which would appear to do little more than replicate laws or provisions which already exist. However, the introduction of an administrative recovery notice mechanism for liquidations, similar to that which presently exists in bankruptcy under s 139ZQ of the *Bankruptcy Act* could be beneficial. This may provide a more cost-effective and expedient process for liquidators to pursue obvious and actionable phoenix transactions under the existing law.

The proposed new 'phoenixing offence' appears to already exist in the form of s588FE(5) of the Act.

Replicating the s 139ZQ notice regime which presently exists under the *Bankruptcy Act* could provide assistance to liquidators in pursuing illegal phoenix activity. The ability of the recipient of a notice to apply to Court to have it set aside should be factored in to any proposed change.

Liquidators are routinely hampered in their investigations by a lack of books and records to evidence a particular transaction the liquidator suspects of being questionable. They are also hampered, particularly in no fund liquidations, by their lack of ability to cost effectively obtain evidence that may be held by a third party. The introduction of a mechanism where liquidators had statutory powers to make written requests of third parties for books and records would be beneficial.

Directors should face more serious consequences for not delivering books and records of a company to a liquidator or not maintaining books and records in accordance with s 286 of the Act.

Consideration should be given to strengthening Division 2 of Part 5.7B of the Act by amending the wording slightly in Section 588FDA from “close associate” to “related entity”. This would allow a liquidator to pursue companies and trusts, not just relatives (individuals) of the director(s). There have been some cases where the Courts have allowed such a recovery against corporate entities and broadened the scope of the section, but not on all occasions so it creates some uncertainty for a liquidator as to an outcome.

Question 7:

What are the benefits and risks of this approach?

There is little benefit in the new ‘phoenix offence’ (as it largely already exists) but there could be advantages in providing for an administrative recovery notice regime.

Care is needed to ensure legitimate corporate restructurings are not captured under a phoenix offence or by a s 139ZQ notice.

Question 8:

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

ASIC retaining control of the issuing of administrative recovery notices would add complexity and time to the detriment of any benefit of such 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). The ability of liquidators to issue notices independently would be beneficial by reason of the expediency with which remedies could be sought against perpetrators or beneficiaries of illegal phoenix activity.

Question 9:

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

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. 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.

Question 14:

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

An administrative recovery notice regime would reduce the time and costs of taking action to avoid illegal phoenix transactions and obtain compensation for creditors. Administrative notices would effectively reverse the onus which usually rests on the liquidator to issue formal court processes to claim such compensation. If payment is not made under the notice, then court proceedings will still need to be issued to recover that amount as a debt. However, this type of legal proceeding is a more straightforward proposition.

Question 15:

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

The ability of a recipient to apply to Court to set aside a notice should be a sufficient safeguard.

Question 16:

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

We refer to our comments above in respect of the existing s 588FE(5) of the Act. The notion of an administrative recovery notice regime would appear to complement all existing voidable transactions provisions. As a result, we do not see any reason for amendments or repeals to the existing voidable transaction provisions.

Question 17, 18 and 19:

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

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)?

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

Apart from the notion of an administrative recovery notice, there seems to be ample existing laws and remedies which address illegal phoenix activity. 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.

Question 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

Question 21:

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

We repeat our comments above for Questions 17 to 19. Breaches of existing obligations need to be subject to harsher penalties and enforced. Being designated a 'Higher Risk Entity' as a result of a blatant breach of the law would appear to serve little purpose. A more appropriate manner of recognising a wrong-doer as high-risk would be to prosecute that person's breaches of the law and impose the relevant penalty.

Addressing issues with directorships

Question 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: 8

Question 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?

Yes, subject to the director having some control over, or responsibility for, reporting the resignation.

Question 24:

What are the benefits and risks of this approach?

We see no obvious risks or downside to such an approach.

Question 25:

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

It is our view that 28 days to notify a director's resignation is too long. A period of 14 days (or 10 business days) is more reasonable, particularly if the responsibility for notification attaches to the director individually. If a director is resigning for a proper purpose, they should be eager to see the public details of their resignation updated in as short a time frame as possible.

Question 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 consider it would be appropriate for the responsibility for notifying ASIC to attach to the individual director who has resigned. This would provide a direct benefit to directors in that they can obtain certainty that their resignation has been acknowledged and recorded. This would not seem to be a significant compliance burden.

Question 27:

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

This should only be capable of being overturned or rebutted upon application to Court.

Question 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: 8

Question 29:

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

No, in the case of sole directors, they should not, particularly where the director is not independent of the shareholder(s).

Question 30:

What are the benefits and risks of this approach?

There are no obvious risks of this approach, save for the situation which may arise if there are only two remaining directors of a company. If one of those directors resigned, this would leave the remaining sole director unable to resign unilaterally. Therefore, consideration might be given to whether a director, whose resignation would leave a company with a sole director, must first give a period of notice to the other director who stands to be the sole remaining director after that resignation takes effect. This would at least give the prospective sole remaining director some advance notice of the situation in which they will soon find themselves by reason of their fellow director's resignation. Consideration should also be given to the fact shareholders can replace/appoint directors, but this is obviously an issue where the director is a related party to the shareholder(s).

Question 31:

Should abandoning a company instead be an offence?

No. In our view 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 require the usual declaration from the director as to the company's position including its assets and liabilities).

Restrictions on voting rights

Question 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: 8

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.

Question 35:

What are the benefits and risks of this approach?

The ILRA has introduced reforms to enhance the rights of creditors to replace external administrators. In our view these rights would be supported and complemented by a further measure which restricts the ability of related creditors to 'block' or obstruct the attempts by arms-length creditors to replace an external administrator if there is a perception that the practitioner chosen by the directors will not act in their interests. These new rights of replacement are one reason we submit that a cab rank system of appointment is unnecessary.

That said, we observe that any exclusion of related creditor votes will only be effective to the extent that a liquidator is aware of – or able to verify – a creditor's 'related' status.

Question 39:

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

We do not support a broad restriction on related creditor voting rights for all resolutions in external administrations. Subject to substantiation of their claims, related creditors are still creditors and legitimate stakeholders in an insolvency process. To the extent that the primary concern surrounds the ability of related creditors to block the attempts of arms-length creditors to override the

directors' choice of external administrator, any restriction of related creditor voting rights should be targeted to this scenario and this issue.

Where related creditors in an external administration constitute a majority in number or value, broadly excluding their voting rights would hinder the efficient and cost-effective conduct of external administrations. For example, approval of remuneration could be more likely to necessitate an application to court if there are insufficient arms-length creditors to approve remuneration (whether due to a lack of quorum or because no arms-length creditor responds to a proposal without meeting).

In some cases, related party creditors are the only creditors of a company. In this scenario, if the restrictions extended to all resolutions – in a voluntary administration appointment, there would be no creditors to vote to place the company into liquidation or a Deed of Company Arrangement ('DOCA'). Further, if these companies are part of a group of companies where proposed DOCAs are interdependent on the acceptance by each company, DOCAs for all the companies could fail even if they are in the best interests of all creditors purely because there are no 'unrelated' creditors to pass resolutions.

Question 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 repeat our answer to Question 39. If the restrictions on voting rights of related creditors are limited to removal/replacement resolutions, we do not see any additional complexities for the conduct of external administrations.

Question 41:

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

No.

Question 43:

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

No.

Question 46:

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

We firmly reject the proposition that collusion between liquidators and related party creditors is an issue or problem of a general or widespread nature. The Consultation Paper itself acknowledges that 'the overwhelming majority of registered liquidators … have done the right thing.' The few registered liquidators who allegedly are not 'doing the right thing' should be the focus of regulatory attention and action.

We note it is now law that registered liquidators make a declaration of relevant relationships and a declaration of indemnities in both voluntary administration and CVL appointments. These must be sent to the company's creditors and lodged with ASIC very early in the administration or liquidation process. Failing to do so is an offence.

Promoter penalties

Question 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: 2

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

There are already consequences of facilitating illegal phoenix activity.

Instead of creating new laws, existing laws should be better enforced.

Any consideration of this measure needs to ensure legitimate corporate restructurings are not captured.

Question 48:

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?

Existing law already addresses the issue. New law is not necessary.

Extending the Director Penalty Notice regime to GST

Question 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: 7

Question 56:

What are the benefits and risks of this approach?

Whilst this proposal has some merit, we are generally concerned about the ATO's increasing priority position and the impact that has on ordinary unsecured creditors, particularly small business creditors. The ATO's priority status was purposely removed by legislators many years ago.

Security Deposits

Question 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: 5

Question 60:

What are the benefits and risks of this approach?

The benefits are greater protection for the ATO, but this is at the potential detriment of other unsecured creditors.

Question 61:

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

The use of garnishees unfairly advantages the ATO. If the ATO is going to have the power to garnishee, the garnishee proceeds should be subject to potential recovery as preferential payments in the event of a subsequent liquidation. All other creditors that receive payments from a company that may be insolvent run the risk of the payment being subsequently recovered and it is unfair that the ATO can avoid this risk.

Question 63:

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

We do not agree that future tax liabilities should be able to be addressed by expanding the garnishee power. We do not agree with the unfair advantage provided to the ATO by the current use of garnishees. Extending garnishee powers to possible future tax liabilities would only increase this advantage to the detriment of the company's other unsecured creditors.

Question 65:

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

Yes, as mentioned in Question 61, garnishees provide an unfair advantage to the ATO as the ATO is able to obtain payment without risk of subsequent recovery as a preference.

In addition, they give the ATO the ability to step around the priority provisions of the Act, elevating them above not only unsecured creditors, but also secured creditors if a garnishee notice is issued on the purchaser of a property from a liquidator, receiver, administrator or mortgagee. We reiterate that the ATO's priority status was purposely removed by legislators many years ago. The ATO should be given no greater rights than an ordinary unsecured creditor.

Dealing with Higher Risk Entities

Targeting higher risk entities

Question 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: 3

Question 69, 70, 71, 72 and 73:

What are the benefits and risks of this approach?

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?

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

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?

Should 'associate' be defined or determined administratively?

Many of the features of the proposed 'objective test' for designation as a 'Higher Risk Entity' ('HRE') are already either breaches of existing laws (eg, failure to provide books and records to a liquidator) or factors which are existing elements of the provisions in Part 2D.6 of the Act which provides for the disqualification of persons from managing corporations.

Part 2D.6 of the Act already outlines a process for designating and dealing with 'high risk' persons. Instead of constructing another similar regime, these existing laws could and should be enforced with greater resolve.

A person may be disqualified by the Court or by ASIC for involvement in the failure of two or more corporations (ss 206D and 206F of the Act). ASIC's power of disqualification is based on the lodgement of a s 533 report by a liquidator for each of the corporations concerned. A s 533 report may be lodged due to either apprehended misconduct/breach of duty or the inability of the company to pay unsecured creditors more than 50 cents in the dollar.

s 533 reports lodged by us are rarely acted upon by ASIC.

If the stated intention is indeed to 'target the most egregious illegal phoenix operators who have adopted phoenixing into their business model' then the existing disqualification regime in Part 2D.6 of the Act is sufficient to enable regulator action to prevent these individuals from continuing to trade through a corporation.

In terms of risks of the proposed approach, it appears reasonable to assume that notification of a decision to declare an individual a High Risk Phoenix Operator ('HRPO'), followed by a review process, would simply increase the operator's apprehension of forthcoming regulator action. This may simply serve as a 'tip-off', prompting earlier sharp practices before the regulator moves to apply any 'preventative measures'.

Appointing liquidators on a cab rank basis

We observe that:

- The Consultation Paper refers to the 'incentive' or 'opportunities' for registered liquidators to facilitate illegal phoenix activity but cites no evidence in support of the widespread presence of such activity;
- Australian general law independence standards are rigorous and case law in recent years has demonstrated that the existing laws are able to address problematic referral relationships and their potentially adverse impact on investigations carried out by an external administrator;
- Recent changes to the law implemented by the ILRA have made it easier for creditors to replace an external administrator if they are dissatisfied with the performance of an incumbent practitioner in the discharge of his/her role and responsibilities;
- 'High risk phoenix operators' could be identified and dealt with under existing laws (eg, director disqualification provisions) so that there are fewer 'phoenix operators' managing corporations in the first place.
- Designating someone as a HRPO will not stop them having someone else appointed (commonly a relative) as a director and then continuing to trade a business as a shadow director.
- The Consultation Paper acknowledges the role played by 'pre-insolvency advisers' in facilitating phoenix activity. Unlike legal practitioners and registered liquidators who are entitled to give advice to directors of insolvent companies in the course of lawful and regulated professional practice, pre-insolvency advisers who facilitate phoenix activity would appear to be doing so in blatant breach of existing legislation.

Option 1: High risk phoenix operators

Question 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

The notion of a cab rank or 'roster' system for the appointment of external administrators to voluntary insolvency procedures has previously been considered – and rejected – in Australia.

In respect of voluntary appointments, the 1988 *Harmer Report* addressed the notion of a 'roster basis' for the appointment of an administrator. After acknowledging the importance of the independence of administrators and that 'the administrator not be the 'puppet' of the directors', the Commission concluded that:

> *'A roster system would detract from the voluntary nature of the procedure. The quality of administrators would inevitably vary from person to person. The directors may have proposals for dealing with the company's insolvency. In fact, the existence of those proposals may have encouraged the directors to have the company voluntarily submit its affairs to a particular insolvency administrator. Therefore, it is important that the company, at least in the initial stages, should have some freedom of choice in appointing the administrator.'*

The Harmer Report also acknowledged that there were other 'sufficient safeguards towards ensuring … independence': Registered liquidators have appropriate experience and qualifications and owe general law duties of independence which can, in some circumstances, justify a court order for their removal. Certain close connections between a practitioner and a company will also disqualify a practitioner from taking an appointment.

Liquidators and administrators are disqualified under the Act from taking appointments in the event of certain pre-appointment connections with the company. General law duties of actual and perceived independence also apply to liquidators and administrators.

There would be practical difficulties in the efficient administration of a cab rank or 'roster' system which incorporates (as it must) a right to refuse consent to an appointment on various grounds (e.g., conflict or time, experience or resource constraints). It is possible that up to a week could pass before an appointee accepts an appointment. This delay may result in significant prejudice to creditors.

The previous court 'roll' which was used to appoint Official Liquidators in court appointed liquidations is not a comparison as usually some 6 weeks elapsed between the provision of a consent to act and the actual appointment. The time pressures are not the same as they are in voluntary administrations and many CVLs. We note that over time the 'roll' was used less and less by courts, petitioning creditors were directly contacting registered liquidators to provide consents to act. This practice has all but ceased now with the removal of the 'Official Liquidator' designation earlier this year.

It stands to reason that the few 'dishonest liquidators' said to exist – and whose existence is the very rationale for the notion of a cab rank system – will also be panel liquidators, capable of taking appointments over companies whose officers are HRPOs. There is no suggestion in the Consultation Paper that any registered liquidator will be ineligible as a panel liquidator for the proposed cab rank.

This highlights the logical flaw in the proposed cab rank system: unscrupulous registered liquidators need to be sanctioned or deregistered rather than be incorporated into a modified appointment system which is designed to rein in their conduct. Alternatively, any notion of excluding certain registered liquidators from the cab rank panel would beg the question as to why

the individual is still registered at all. ILRA reforms that commenced in March 2017 mean that registered liquidators now need to reapply for their registration during the first twelve months from that date and then at the end of each three year period. ASIC were also given broader disciplinary powers over registered liquidators. ASIC now has greater powers to 'weed out' the very few liquidators who do not do the right thing.

Importantly, the very existence of a cab rank is anti-competitive. As the Harmer Report alluded to, the quality of the performance of various practitioners should be expected to affect directors' choice of practitioners for prospective appointments. If the decision to engage professionals with a track record of high quality work is taken out of the hands of the market and put under Government control, this diminishes competition. It could be said that it reduces incentives for practitioners to aspire to excellence and efficiency in service delivery.

For the same reasons, a cab rank system will mean that the costs of some external administrations will be higher than they otherwise would have been. Some directors, faced with the choice between two practitioners of commensurate standing and quality, will not be able to choose the one with lower charge-out rates. This is how competition can work for the benefit of stakeholders in an external administration.

Ultimately, a cab rank is a step towards the 'de-professionalisation' of the highly specialised and expert work performed by registered liquidators. Similar considerations apply to the notion of a Government liquidator, addressed in more detail below.

Question 75:

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

Rather than establishing and administering a cab rank, a more effective use of ASIC's current expenditure on the regulation of registered liquidators (currently estimated at $10.2 million in annual costs) could adequately address any liquidators who have been identified as facilitating their appointors' interests to the detriment of creditors.

Recent ILRA changes have enhanced the ability of creditors to replace external administrators 'as of right', rather than having to apply to a court and 'show cause' for the replacement of the practitioner. These mechanisms, which have only been in force for less than two months, will provide creditors with the means to take appropriate action where there is an apprehension that a liquidator either lacks independence, is not carrying out due investigations or is failing to fulfil any other aspect of his/her role and duties.

Excluding related party creditor votes for the purposes of voting on a resolution to replace an incumbent practitioner would strengthen these new rules and make them work even more effectively.

Given these recent improvements to creditors' rights to replace external administrators, the idea of a cab rank appears extremely premature.

Question 76 and 77:

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.

Should a cab rank apply to all external administration appointments?

A cab rank system of appointments does not have merit for any type of appointment of an external administrator.

The potential problems and impracticalities of a cab rank rule are exacerbated for voluntary administrations, where there may be a very real need to make an urgent or timely appointment of a practitioner with appropriate industry experience and requisite resources. It is crucial in large

entities or groups that a liquidator with the appropriate resources to mobilise staff to multiple locations if necessary is appointed. Not all registered liquidators have the resources to conduct all sizes of appointments. Similarly, some appointments benefit greatly from prior industry experience and knowledge, no two liquidators have exactly the same experience. The administration of a roster system of appointment could mean several days to complete an appointment and obtain the Part 5.3A statutory moratorium. Such a delay could prejudice the preservation of business value or compromise potential outcomes and returns to creditors.

Question 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 company's 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 are not convinced of the capacity for a cab rank system to be applied accurately and efficiently against the above criteria.

To the extent that circumstances of pre-insolvency advice, financial affairs and asset transfers were relevant criteria, presumably this would necessitate a declaration or provision of information by directors, which would then be used for the purposes of administering the cab rank. Again, this administrative process would take time and, in any event, the outcome would be only as reliable as the declarations or information provided by directors.

Another important consideration in applying a cab rank to, say, CVLs but not to voluntary administrations is that this may create the unintended consequence of directors favouring one type of procedure over another solely due to the ability to invoke a voluntary appointment procedure. Insolvent companies which are suited to a CVL may become the subject of voluntary administration appointments when in fact liquidation is the only feasible fate for those companies. This would have the unintended consequence of a potentially more expensive (due to the higher statutory obligation requirements) type of appointment being used to the detriment of creditors.

Under the current law creditors can influence the choice of insolvency practitioner who acts as either administrator of a deed of company arrangement or liquidator following a voluntary administration. In a voluntary administration, creditors also have the right to replace voluntary administrators at the first meeting of creditors held shortly after appointment.

Question 79:

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

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.

Question 80:

How do you think such a system should be funded?

The notion of a cab rank appointment mechanism is an excessive measure, the cost of which will be disproportionate to the 'opportunities' stated to exist for a 'dishonest liquidator' to facilitate misconduct.

The Consultation Paper itself acknowledges the 'overwhelming majority of registered liquidators who have done the right thing'.

On the matter of funding liquidators to conduct basic investigations and reporting, we acknowledge and 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.

A Government liquidator

Question 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

Question 82, 83 and 84:

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

What are the benefits and risks of this approach?

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

We do not support of the notion of a government liquidator to conduct external administrations (regardless of their size, however that might be defined or determined). We see the following general, and major, issues with the idea of a government liquidator:

- The existing profession of private, registered liquidators is better placed – in terms of resourcing, efficiency, competence, expertise and costs – to conduct external administrations. What is needed is more funding of registered liquidators to enable them to carry out investigations and take the necessary action to pursue perpetrators or beneficiaries of illegal phoenix activity. Registered liquidators are part of the solution, not part of the problem.
- The Commonwealth Government is often a major creditor in external administrations, either through the ATO or the Department of Employment which administers the FEG Scheme. The ATO is routinely met with unfair preference payment claims. For this reason, issues and questions arise as to the independence or potential conflict of interest where a major creditor is responsible for conducting an external administration and deciding whether to appoint a private registered liquidator (and who to appoint).
- Some existing practices (including those in rural areas) focus mainly on small to medium external administrations, we fail to see how the introduction of a government liquidator could not be seen as anti-competitive and anti-entrepreneurial. There is a risk good practitioners will be forced out of business.

Question 85:

How do you believe a government liquidator should be funded?

We do not support the notion of a government liquidator and again submit that serious consideration should be given to increasing Government funding of registered liquidators to investigate and pursue existing remedies for illegal phoenix activity. This is far preferable to allocating scarce Government resources and funding to actually conducting external administrations.

Removing the 21-day waiting period for a DPN

Question 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: 2

Question 87:

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

No, directors are entitled to a period in which to attempt to deal with the DPN (noting that we do not agree with the HRPO designation).

The fact that DPNs are served at the time they are put in the post also means that if this change were made, enforcement could occur with no notice.

Question 88:

What are the benefits and risks of this approach?

It is likely that sophisticated directors will not hold any substantial assets in their own names and will have taken steps to minimise their personal risks prior to taking directorships (for example through the transfer of assets into trusts). This will have occurred well before any DPN is issued.

If the director is unable to pay and ends up bankrupt, the bankruptcy trustee has powers to recover assets for the benefit of the estate where applicable. The laws already exist to overcome the behaviour set out in the consultation paper, trustees just need to be funded to take the needed action.

Providing the ATO with the power to retain refunds

Question 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: 2

Yours faithfully

Craig Shepard
Partner