McGrathNicol

McGrathNicol
Partnership
ABN 41 945 982 761
Level 7, 175 Eagle Street
Brisbane QLD 4000, Australia
GPO Box 9986
Brisbane QLD 4001, Australia
T +61 7 3333 9800
F +61 7 3333 9899
mcgrathnicol.com

27 October 2017

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

Email: phoenixing@treasury.gov.au

Dear James

By Email

Proposals for combatting illegal phoenixing- response to consultation paper

McGrathNicol is a national boutique advisory firm, with services that include restructuring and insolvency. Fifteen of our partners are registered liquidators. The majority of our registered liquidators are members of the Australian Restructuring, Insolvency and Turnaround Association **(ARITA)**. Our insolvency practice is confined to corporate matters and we do not practise in bankruptcy.

McGrathNicol welcomes the opportunity to provide our comments regarding the proposed measures to deter and disrupt phoenixing behaviour. Moreover, notwithstanding any of our comments in regard to specific proposed measures, McGrathNicol fully supports the government's focus on illegal phoenix activity and its efforts to implement a range of measures designed to collectively prevent or disrupt such activity which causes great detriment to the economy.

We have engaged with ARITA and have reviewed its detailed submission on this issue, which we largely endorse. We have identified four issues where our views diverge to some degree from ARITA's.

Our response is structured in the following manner:

- comments and further explanation on issues where we have a differing viewpoint or additional comments from those expressed in the ARITA submission; and
- responses to the specific questions posed by numerical rating.

A. Supplementary comments to ARITA's submission

Our comments below provide a short explanation of our views where they diverge in some respect to those set out in the ARITA submission. The numbering follows directly from the consultation paper.

2 Phoenixing Offence

McGrathNicol supports the proposal to amend the *Corporations Act 2001* (**Act**) to specifically prohibit the transfer of property from a company to another entity, if the main purpose of the transfer was to prevent, hinder or delay the process of that property being divisible amongst the transferor company's creditors.

McGrathNicol supports modelling such a provision on section 121 of the *Bankruptcy Act 1966* – Transfers to Defeat Creditors. Whilst acknowledging ARITA's position that an analogous provision is contained in subsection 588FE(5) of the Act, McGrathNicol considers that a stand-alone provision will serve as an unambiguous deterrent and a clear prohibition against conduct which amounts to illegal phoenixing. We support the introduction of a provision that reduces the challenges and complexity of establishing the elements of the cause of action under subsection 588FE(5) and:

- includes an 'inference' test rather than a 'purpose' test;
- is not dependent upon the transaction being an insolvent transaction; and
- includes civil penalty sanctions and/or criminal sanctions.

That said, we fully concur with ARITA's over-riding observation that any new law will be futile if it is not enforced through lack of powers, funding or will.

3 Addressing issues with directorships

Section 205A of the Act provides a mechanism for directors to notify ASIC of their resignation or retirement, rather than rely on the company to provide the notice of resignation to ASIC. As public and listed companies are subject to additional legislative and ASX notification requirements and are not, we understand, the primary target of anti-phoenixing measures, McGrathNicol supports the shifting of the onus for reporting director resignations to the individual director only for directors of proprietary companies.

We otherwise support ARITA's comments regarding addressing issues with directorships.

4 Restrictions on voting rights

Recent changes to insolvency law have given the power to creditors to remove and replace an external administrator (**EA**). McGrathNicol recognises that these powers are capable of exploitation by unscrupulous operators seeking to either avoid attempts by other creditors to remove an EA who is or is perceived to be inappropriately compliant or "friendly" or seeking to appoint a "friendly" EA against the wishes of third party creditors by "stacking" the voting with related party creditor votes.

Whilst philosophically opposed to measures which reduce the rights of parties without evidence of wrong–doing (in this case, bona-fide related party creditors) and notwithstanding a concern that the measures may put bona-fide related party creditors at a disadvantage in circumstances where an EA is considered unduly "friendly" to the interests of a third party creditor (who may be subject to a preference claim for example), on balance we support the proposed measure because:

- the measure will only have effect where the wishes of the related party creditors differ from those of the unrelated party creditors;
- bona-fide related creditors disenfranchised by the measure retain the right to take their concerns to the Court, which prior to the recent changes was their only course of action;
- we consider the disruption of the capacity of illegal phoenix operators to stack the votes to achieve their objectives as an effective measure against illegal phoenix behaviour;
- we perceive the damage to the economy and creditors, including the Commonwealth, as a result of illegal phoenix activity as outweighing the damage which may arise from bona-fide related party creditors having to resort to the Courts to remove or prevent the removal of an EA.

9 Appointing liquidators on a cab rank basis

On page 27 of the proposals paper, concerns are raised about the independence of liquidators being compromised by commercial dependency on referral sources. We note that recent changes to the Act now require that every Declaration of Independence, Relevant Relationships and Indemnities **(DIRRI)** specifies the referral source and the DIRRI must now be lodged with ASIC. Accordingly, ASIC will now have much better information about the level and nature of referrals being provided to liquidators which should allow more targeted and effective regulation of practitioners that do not meet the standard of independence required of them by law and professional standards.

In our view, using this newly available information to focus regulatory activity would be a much easier and more cost effective way to address the identified mischief than implement any variation of a cab rank approach – the pitfalls of which ARITA has well articulated.

11 ATO to Retain Refunds

McGrathNicol supports the broadening of the ATO's powers to retain refunds for all companies that have failed to make the required notifications, lodgements or payments in respect of tax (including GST) or superannuation. In addition, McGrathNicol supports the ATO's powers being extended to offset a refund against any form of outstanding tax liability.

B. Rating response to each question posed by the consultation paper

Reform Number	Reform	Question Number	Rating (1 -10)
1	Phoenix Hotline	1	2
2	Phoenix Offence	6	7
		20	8
3	Issues with Directorships	22	7
		28	9
4	Restrictions on Voting Rights	34	6
5	Promoter Penalties	47	2
6	Extending the DPN Regime to GST	55	9
7	Security deposits	59	2
8	Targeting Higher Risk Entities	68	2
9	Appointing Liquidators on a Cab Rank Basis	74	1
		81	1
10	Removing DPN 21 Day Period for compliance	86	1
11	ATO to Retain Refunds	91	7

Please contact me on telephone number (07) 3333 9806 if you have any questions or if we can provide any additional assistance.

Yours faithfully

Anthony Connelly
Partner