Maurice Blackburn Lawyers
Since 1919

Maurice Blackburn Pty Limited
ABN 21 105 657 949

Level 21
380 Latrobe Street
Melbourne VIC 3000

DX 466 Melbourne
T (03) 9605 2700
F (03) 9258 9600

27 September 2018

Nathania Nero
Senior Adviser
Corporations Policy Unit
Consumer and Corporations Division
The Treasury
Level 5, 100 Market Street
SYDNEY NSW 2000

Email: Phoenixing@treasury.gov.au

Dear Mr Nero,

We welcome the opportunity to provide feedback in relation to the draft legislation on reforms to combat illegal phoenix activity.

Please do not hesitate to contact me via GSivaraman@mauriceblackburn.com.au or on 07 3016 0332 if we can further assist with Treasury's important work in this regard.

Yours faithfully,

Giri Sivaraman
Principal
Employment & Industrial
Maurice Blackburn

Submission in response to draft legislation on reforms to combat illegal phoenix activity.

September 2018

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Introduction

Maurice Blackburn Pty Ltd is a plaintiff law firm with 31 permanent offices and 29 visiting offices throughout all mainland States and Territories, nationally. The firm specialises in, medical negligence, public liability, transport accidents, work accidents, dust diseases, superannuation (particularly total and permanent disability claims), negligent financial advice disputes, and consumer & commercial class actions.

Maurice Blackburn employs over 1000 staff, including approximately 330 lawyers who provide advice and assistance to thousands of clients each year. The advice services are often provided free of charge as it is firm policy in many areas to give an obligation free first consultation at no cost to the client. The firm also has a substantial social justice practice.

Apart from representing workers regarding their employment rights and workplace health and safety, Maurice Blackburn engages in policy work advocating for workers' rights and those disadvantaged in our community.

Our Submission

The Australian Treasury has released draft legislation providing a comprehensive package of reforms to combat illegal phoenix activity.

Maurice Blackburn notes that the drafters have incorporated measures to deter and disturb the nature of illegal phoenix activity and provide appropriate punishments to those who are complicit or facilitate illegal phoenix activity.

Maurice Blackburn is pleased to provide two case studies which demonstrate the impact on workers of the current regulatory framework applicable to phoenix arrangements. The stories confirm the ongoing issues that Maurice Blackburn faces when there is deliberate and contrived corporate insolvency.

We are mindful that often those most at risk of falling victim to illegal phoenix activity are from the most vulnerable workers, engaged in the most precarious working arrangements. They are often those who hold the lowest status in employment relationships. The protections afforded through union membership are often ignored through fear that it may jeopardise their capacity to gain or retain work.

Maurice Blackburn is also pleased to provide responses to the proposed reforms and offers further recommendations which we believe will go some way in reducing the impacts of illegal phoenix activity on workers.

In this submission, we have made a number of recommendations in relation to the clarity of 'market consideration', the resourcing of regulators, the requirements relating to illegal phoenix activity within group structures, broadening the scope of Director Penalty Notices, the role of credit agencies, the training of directors, and advanced made under the Fair Entitlements Guarantee scheme (FEG).

Maurice Blackburn would be pleased to provide any further assistance to Treasury in determining the appropriateness of the proposed reforms.

Background

In recent times, there has been significant concern regarding the substantial social and economic costs of illegal phoenix activity.

Figures which have emerged from government, and other agencies demonstrate the seriousness of the issue. For example, in 1996 the then Australian Securities Commission (now known as the Australian Securities Investment Commission (ASIC)) declared that the annual loss due to illegal phoenix activity was between $670 million and $1.3 million per year[1].

A more recent report prepared by PricewaterhouseCoopers Consulting (Australia) Pty Limited (PwC) estimated that between the years 2015-2016, illegal phoenix companies cost individuals approximately $31 to $298 million in unpaid entitlements, including unpaid wages, leave payment in lieu of notice, redundancy, long service leave and superannuation.

A 2017 paper released by the federal government suggested that the incidence of illegal phoenix activity was on the rise with more people terminated because of their employer's insolvency, making them more reliant on the FEG[2].

The FEG is considered a 'last resort' to assist employees who have lost their employment due to the employer's business collapsing and the employer having failed to adequately provision for employee entitlements. The cost under the FEG has significantly increased with payments equating to more than $1billion from 2012-2013 to 2015-2016[3].

The table below outlines the cost of total payments made to redundant workers under the FEG since 2007-2008 to 2015-2016[4]:

Financial year	Cases paid	Persons paid	Costs ($ millions)
2007-08	983	7808	60.8
2008-09	1346	11027	99.8
2009-10	1869	15565	154.1
2010-11	1623	15413	151.3
2011-12	1737	13929	195.5
2012-13	1755	16019	261.7
2013-14	1113	11255	197.2
2014-15	2060	19074	312.5
2015-16	1746	14341	284.1

The increased reliance on the FEG scheme to cover the payment of employee entitlements should act as a catalyst for seeking alternative mechanisms which may reduce the burden on taxpayers and ensure workers entitlements.

Illegal Phoenix Activity

There is no law in Australia that defines 'phoenix activity'. Nevertheless, a range of laws apply to the underlying illegal behaviours that may present in phoenix activity.

[1] Australian Securities Commission *Phoenix Companies and Insolvent Trading*- An ASIC research report July 1996 (the ASC report)
[2] Australian Government, Treasury and Department of Employment *Reforms to Address the Corporate Misuse of the Fair Entitlements Guarantee Scheme: Consultation paper* May 2017
[3] Ibid
[4] Ibid

The concept of phoenix activity broadly centres on the idea of a debt-laden company failing and a second company, which is newly incorporated 'arising from the ashes' debt-free with the same controllers, running the same economic enterprise of the previous company. Importantly, phoenix activity is not of itself illegal.

Maurice Blackburn notes that restructuring a business after its failure may be the result of an unsuccessful, completely innocent and well intentioned display of entrepreneurship.

The conduct may become illegal, however, if it involves a deliberate and contrived act to close a debt-laden company to avoid paying creditors, taxes and employee entitlements. The debt is effectively quarantined and unrecoverable from the insolvent company. Therefore, a factor that categorizes an illegal phoenix activity is intent.

With the growth of more complex employment structures in Australia including labour hire companies; there are more and more instances of illegal phoenix activity taking place within corporate groups. This occurs where a subsidiary of a parent company is arranged in a way that accrues all the tax and super liabilities, but is then liquidated. Effectively, the remaining companies in the corporate structure are entitled to enjoy the benefits from the insolvent entity, however remain unscathed and financially unaffected.

These activities have the potential to have a drastic impact on workers and their families.

Maurice Blackburn is pleased to provide two case studies which demonstrate the impact on workers of the current regulatory framework applicable to phoenix arrangements. The stories confirm the ongoing issues that Maurice Blackburn faces when there is deliberate and contrived corporate insolvency.

It is through these case studies that Maurice Blackburn provides submissions in response to the proposed reforms and offers further recommendations which Maurice Blackburn believes will go some way in reducing the impacts of illegal phoenix activity on workers.

The Human Cost of Illegal Phoenix Activity

Case Study #1: Franchisor 7 Eleven

The case of Mustafa (not his real name) is a case similar to the stories of many Maurice Blackburn clients who have fallen victim to illegal phoenix activity.

After dropping his resume at a number of stores in his local area – a Victorian regional city – Mustafa left his resume at the 7-Eleven store located on a busy local street and spoke with manager Martin (not his real name).

Martin subsequently rang Mustafa and asked him to come to the store for training. Mustafa attended at the store and performed four or five training shifts a week, for approximately two and a half months. Mustafa was not paid for any of these shifts.

In approximately April 2007, Mustafa met with the co-owner of the franchise. She said that she would pay Mustafa $10.00 per hour worked, before tax. She said that Mustafa would work 40 hours a week but that, on his payslips, it would only state that he worked 20 hours a week so that he would not have any problems with his visa. The co-owners of the store never informed Mustafa of the minimum wage or that his employment was covered by an Award.

Mustafa worked six shifts a week, from 7:30pm to 8:30am (though rostered from 8:00pm to 8:00am) at the local store.

From 14 December 2007, Mustafa ceased working at the local store and commenced at another owned by the couple in a Melbourne suburb. Though Mustafa worked the hours of 9:30pm to 8:30am, for approximately 50 to 60 hours each week, he was only paid for work performed between 10:00pm and 8:00am. Mustafa was not allowed to take rest or meal breaks while working at either of these stores.

When Mustafa received his first payslip he noticed that it appeared to show that he had only worked half the hours that he had actually performed. The payslip suggested that he was being paid twice the amount per hour than he was in fact receiving.

On questioning this with Martin, he suggested that this arrangement benefited Mustafa because he could not work more than 20 hours due to his student visa. Moreover, Mustafa was advised by the co-owners of these stores that he would be in trouble with immigration if he talked to anyone about his pay.

On another occasion, when Mustafa requested an advance on his wages to assist in paying for his university fees, he was advised by one of the store owners to: *"run away to Melbourne, don't study and waste your time and money. I will give you more hours in Melbourne".*

The underpayments continued throughout the course of Mustafa's employment with these franchisees. Mustafa's bank statements suggested that after tax, he was earning $5.00 for each hour of work net.

The full amount was not paid and proceedings commenced, however following a court order and the payment of penalties the franchisees became insolvent with Mustafa only receiving $8,000.00 of the at least $28,500.00 owed to him (on the Fair Work Ombudsman's calculations). Mustafa believes the directors simply 'phoenixed' and opened a new 7-Eleven store elsewhere.

Case Study #2: Franchisor Miss India

The case of Bob (not his real name) is another story which considers illegal phoenix activity within the franchise business model.

Bob was formerly employed at the Miss India franchise as a Head Chef and Store Manager from October 2006 until his termination on 13 October 2014.

At the commencement of his assignment at the Miss India franchise, the franchisee advised Bob that he would be a salaried employee, remunerated at approximately $600.00 per week, increasing incrementally over the years. Whilst there was no written agreement that existed between the franchisee and Bob throughout the duration of his assignment at the Miss India franchise, documents were produced which confirmed that he was a permanent employee.

Pursuant to the National Employment Standards (NES) and the applicable Awards; *Hospital Industry - Restaurant Catering and Allied Establishment Award - South Eastern Division 2002* (Pre-Modern Award) and *Restaurant Industry Award* (Modern Award) Bob was eligible for various entitlements including, but not limited to annual leave, annual leave loading, personal leave and penalty rates.

Unfortunately, Bob's employer failed to correctly remunerate Bob pursuant to the relevant Awards and failed to account for accrued long service and annual leave.

Bob attempted to settle the dispute with his former employer through mediation, however this proved unsuccessful. The amount the franchisee offered to settle the dispute was $2,000.00 which was considered inadequate to sufficiently compensate him for his losses.

Consequently, Maurice Blackburn issued proceedings in the Federal Circuit Court seeking payment of the unpaid entitlements.

After filing the notice, it was revealed that the franchisee had sold his Miss India franchise for consideration of $25,000.00. Maurice Blackburn were advised that liquidators were investigating whether the business was sold at fair market value and whether the sale proceeds were accounted for.

Given that the franchise was sold for little value, Maurice Blackburn had concerns that the business owners engaged in asset protection by transferring assets into the name of a spouse or a family member. This reduced the pool of assets or capital that was otherwise available to Bob and other creditors.

Unfortunately, these are just two of many examples that Maurice Blackburn face on a daily basis. The examples highlight the unscrupulous acts and wrongdoings of many businesses and business owners who liquidate a company to avoid their legal liability.

In our experience, often those most at risk of falling victim to illegal phoenix activity are from the most vulnerable workers, engaged in the most precarious working arrangements. They are often migrant workers, students and women, and often those who hold the lowest status in the employment relationship. The protections afforded through union membership are often ignored through fear that it may jeopardise their capacity to gain or retain work.

Employees are significant victims of illegal phoenix activity because their unpaid wages, leave entitlements, payments in lieu of notice and redundancy payments are often sizeable debts of the failed company. Additionally, where a company is deliberately liquidated, the defunct employees will commonly lose their employment.

Over the last two decades various reviews, inquires and legislative reforms have been made to address illegal phoenix activity. However, given the growing number of concerns there is understandably doubt about the effectiveness of further reforms.

Maurice Blackburn seeks to address a number of concerns pertaining to:

- The proposed reforms by Treasury to combat illegal phoenix activity; and
- The current legislative framework within which phoenix activity operates.

Creditor Defeating Transfers

Maurice Blackburn agrees with the Government's proposal to create legislative offences to prohibit creditor defeating dispositions of company property.

Maurice Blackburn also agrees with the proposal that contraventions of the credit defeating provisions should attract both criminal and civil penalties. This would effectively punish deliberate liquidation, and provide and avenue for redress through the recovery of assets for distribution amongst creditors.

In addition, it is contended that by widening the range of persons who can be prosecuted in relation to credit defeating transfers, the reform will have the effect of ensuring other individuals (indirectly involved) who are complicit in illegal phoenix activity are held to account.

Maurice Blackburn agrees with the fault thresholds/elements set for both the criminal and civil penalties.

In particular, we note that to establish a contravention of a civil penalty provision it is sufficient to establish that a 'reasonable person' would know that their conduct would prevent, hinder or significantly delay the disposed property becoming available to creditors.

It is also noted that to establish a contravention of a criminal penalty provision, it is sufficient to establish that the officer or facilitator was 'reckless' as to the result of their conduct.

Maurice Blackburn notes that the draft legislation also provides defences which apply uniformly to both criminal and civil penalty provisions for officers and other persons, including circumstances where the disposition of property was for market consideration.

Maurice Blackburn submits that further clarity is needed with respect to the concept of 'market consideration'.

Maurice Blackburn considers that assessing the adequacy of consideration is difficult especially in circumstances where the controllers of the insolvent company are still permitted to purchase the assets. This issue is compounded in circumstances where obtaining an independent valuation of assets is problematic if the assets are specific to a particular business or if the business operates in a very niche market.

Without further guidance regarding the term 'market consideration' confusion is inevitable and may lead to various valuation methods being used to determine fair 'market consideration'.

Importantly, the concept of fair market value/consideration needs to reflect the remaining level of service potential. It needs to factor in whether the asset in question has been well maintained or is in good condition.

Recommendation #1:
That the proposed legislation or explanatory memorandum provide a framework or guidelines for determining 'fair market consideration'.

This will also enable a consistent approach to the valuation of assets. For example, under accounting standards the depreciation calculations are often used in determining an assets value.

i. Corporate Groups/Sophisticated Phoenix Activity

Maurice Blackburn recommends further changes to address phoenix activity that takes place within corporate groups or sophisticated phoenix structures.

Corporate phoenix activity occurs where a subsidiary of a parent company holds no assets within the corporate group, however incurs substantial liabilities by way of wages, superannuation contributions etc. The debt-laden subsidiary goes into liquidation and

quarantines its debt from the corporate group. This enables another subsidiary to then engage in business activity similar in nature to the insolvent entity absent any debt.

Employees of defunct entities are significant victims as they may or may not be rehired or transferred to another company within the corporate group and are unable to enforce their rights to entitlements against the solvent corporate structure.

Recommendation #2:
That reforms be implemented which require entities within a group structure to have a shared commitment to satisfy unpaid employee entitlements of any insolvent entity within the corporate group.

This is especially important in circumstances where the related entities have benefited from the work performed from workers of the insolvent entity. In this way, contributions orders should be sought from the Court and applied against solvent group members. In adopting this model, considerations and concessions would need to be made regarding the degree of contributions from each solvent group member.

For example, it would include considerations relating to:

- the extent of the benefit received by the solvent entity and
- the extent to which the solvent entity was involved in the management of the insolvent entity.

Alternatively, prior to establishing a subsidiary which holds no assets within the corporate group pre-cautionary measures should be adopted to ensure the financial viability and sustainability of the individual entity. This should include an assessment of whether the entity is able to meet its operating costs and expenses.

ii. ASIC's powers of recovery

Maurice Blackburn welcomes the initiative to grant ASIC powers to make administrative orders to recover property which is the subject of a voidable creditor defeating disposition.

This will alleviate the financial impediments which limit the ability of liquidators to perform their recovery role for the benefit of creditors.

Initially, it may appear that the power to further the private interests of the creditors is contrary to ASIC's central role of enforcement and deterrence (to secure the future compliance for the interests of the wider community).

Maurice Blackburn disagrees with this view and submits that the power, although furthering the interests of individual creditors will inevitably assist ASIC to detect wrongdoing of directors and other persons and deter phoenix activity for the broader public's benefit.

In order to detect and police illegal phoenix activity, Maurice Blackburn believes that ASIC should be granted even wider powers to fund investigations or recovery actions against directors or other persons who have been found to have engaged in misconduct.

The ability of the liquidator to investigate or obtain compensation from directors and other persons is impacted by the amount of assets held by the company. The act of divesting assets from the failing company through illegal phoenix activity not only deprives its creditors of recovery, but also restricts the capacity of liquidators to perform their role.

Whilst the Government's Assetless Administration Fund ('**AAF'**) was setup to help investigate possible offences and other misconduct on behalf of liquidators dealing with companies with few or no assets, criteria to qualify for the 'advance' or assistance is rigid.

In order to qualify for the AAF funding the liquidator is required to obtain necessary evidence to support the enforcement action.

Regulation 109.28 in the ASIC *Assetless Administration Fund: Funding Criteria and Guidelines* (Regulatory Guidelines 109) states that in making a decision about whether to provide funding ASIC is influenced by whether 'sufficient' evidence is available to support the allegations made or to enable an assessment of the prospects of success of the proposed action by the liquidator to pursue recovery of assets where fraudulent or unlawful activity is suspected.

The funding is therefore counterintuitive as it requires a liquidator who has no funding to make substantial enquiries or carry out substantial investigations which removes the pool of funds available to creditors, prior to funding / an advance being issued by AAF.

Further, we refer to the statutory notice and reports liquidators are required to lodge with ASIC as the *"front-line investigators of insolvent corporations"* pursuant to Regulation 16.2-16.5 of the ASIC *External Administrators: Reporting and lodging* (Regulatory Guideline 16).

These reports and notices primarily assist and contribute to ASIC's goal of maintaining integrity in the marketplace and reviewing breaches in the phoenix context. Without funding, the liquidators are unable to investigate and report to ASIC regarding suspected breaches, which curtails ASIC's enforcement role / power.

A further concern of Maurice Blackburn is whether the financial services regulator will be sufficiently funded to pursue phoenix activity (in light of its widened powers). The concern is that where ASIC and/or liquidators are inadequately funded, the culture of abuse and misconduct will continue.

Recommendation #3:
That regulators be sufficiently resourced to pursue illegal phoenix activity.

If we are to expect directors and other implicit parties involved in illegal phoenix activity to abide by the law, then regulators need to be sufficiently funded to act quickly to detect transgressions and prosecute offenders.

Accountability of resigning directors.

Maurice Blackburn considers that the amendments centred on accountability of resigning directors is a necessary measure to strengthen protections against exploitation. It will prevent directors from obscuring or downplaying their role with respect to company decisions.

i. Preventing inappropriate backdating of director's resignations

One of the proposed amendments prevents the backdating of a director's resignation in excess of 28 days. It provides that if a resignation of a director is reported to ASIC more than

28 days after the purported resignation, the resignation takes effect from the day it is reported to ASIC.

This amendment will undoubtedly still require a level of self-reporting from the director or the company. For this reason, Maurice Blackburn is of the view that whilst this amendment will lower the incident of director exploitation it will not prevent/eradicate it.

Maurice Blackburn believes that the Government should consider whether a director should simply be liable for all conduct predating the lodging of the change of directorship form.

Recommendation #4:
That the Government consider making directors liable for all conduct predating the lodgement of the change of directorship form.

This would encourage forms to be lodged promptly. Maurice Blackburn does not view this to be onerous in circumstances where the forms can be lodged online and can be received instantaneously.

ii. Preventing the abandonment of companies

Maurice Blackburn welcomes the amendments designed at preventing:

- a director from resigning and leaving a company without a director; and
- a director from being removed by a resolution of members of a proprietary company and in so doing leaving the company without a director.

Collection of GST estimates

Although the impact of illegal phoenix activity on tax collection is unknown, the 2009 Treasury *Action Against Fraudulent Phoenix Activity: Proposal Paper* estimated the risk to revenue through illegal phoenix activity to be $600 million.[5]

For this reason, Maurice Blackburn welcomes the initiatives to allow the Commissioner to not only collect estimates of Superannuation Guarantee Charge (SGC) liabilities and PAYG holding tax, but also GST. This will be particularly important with respect to the building and construction industry where the ATO estimated that it had written off $10.8 million over the last 10 years in unrecovered GST from approximately 30,000 entities[6]. This significantly reduces the tax recoverable by the Commissioner.

Director Penalty Notices

Under current law, if a company fails to comply with their obligations under the PAYG withholding system or the SGC provisions, the company directors can be held personally liable for the amount owing by the company.

Accordingly, the ATO can commence recovery against directors under the DPN regime in circumstances where the company's liabilities remain unpaid or unreported after 3 months of becoming due.

[5] Australian Government Treasure, *Action Against Fraudulent Phoenix Activity: Proposal Paper* 2009
[6] ATO - *Inter-Agency Phoenix Forum- 12 November 2013* 14 October 2015

Before commencing proceedings against the directors for the unpaid company liabilities, the ATO issues the directors with a Director Penalty Notice (DPN).

Once the DPN is issued, a director can take the following action within 21 days:

- Pay the debt subject of the DPN;
- In this regard, the director also has a right of indemnity to recover the amount paid on behalf of the company;
- Place the company into liquidation or voluntary administration (this has the effect of remitting the personal debt);
- Enter into an arrangement with the ATO to pay the debt.

Whilst under this DPN regime there is no absolute obligation to pay and the director can simply liquidate the company, it is still an important measure to remind directors not to let tax liabilities mount through inattention. Nevertheless, the utility of the DPN system is limited as it ultimately still allows business to avoid corporate tax liabilities.

Recommendation #5:
That Treasury initiate discussions about the introduction of the DPN for state tax liabilities or other tax paid on real property such as a building.

This would have the effect of tightening the requirements around directors of companies that are late in paying other taxes (other than SGC, GST or payroll tax).

Information sharing with credit reporting agencies

The research into illegal phoenix activity suggests that there have been many incidence of directors being involved in multiple failed companies[7].

Maurice Blackburn suggests that potential lenders, via a credit reporting agency should be allowed to view identification profiles of the defaulting directors. The profiles would include information and/or documentation of companies associated with a director seeking finance.

In this regard, it should be noted that in January 2015 draft legislation was released to amend *the Taxation Administration Act* 1953 **('TAA')** to allow, upon satisfaction of certain conditions, disclosure of tax debt information of a business to credit reporting bureaus. Until these changes are introduced, the Commissioner of Taxation is generally prohibited from disclosing information regarding taxpayer's debt.

The proposed amendments however do little to cease illegal phoenix activity for the following reasons:

- The draft legislation proposes disclosure of information relating to the defaulting 'entity'. Accordingly, it does not allow the credit agency to compile and release a profile of the defaulting directors.

- The legislation is limited due to the conditions under which the information can be released. Under the proposed legislative framework, entities whose debt information can be released include companies that:

[7] *At the Coalface of corporate insolvency and phoenix activity: A survey of ARITA and CCIM Members* 2016

- Are registered in the Australian Business Register (i.e. have an Australian Business Number);
- Have a debt which is at least $10,000.00 and is overdue for 90 days;
- Are not effectively engaging with the ATO to manage their tax debt; and
- Have not brought a complaint to the Inspector-General of Taxation which is still active.

Maurice Blackburn submits that this will do little to deter phoenix activity and may even encourage it.

Maurice Blackburn encourages the Government to foster further discussions regarding these reforms to allow the Tax Office to release details of the debt of the primary entity and to create and release identification profiles of the defaulting directors seeking credit. It is argued that in this situation it is appropriate to intervene and preclude a director from incorporating multiple failed companies.

Nevertheless, it is suggested that some discretion should be exercised to ensure that it does not interfere with genuine business rescues or the attempts of a genuine entrepreneur trying to start over following a failed business venture.

In this regard, Maurice Blackburn accepts that it is not, and should not be an offence to be a director of a company which has honestly failed, nor does it reflect that there was a deliberate or contrived attempt to make a company insolvent.

Maurice Blackburn suggests that one way of determining whether or not the information should be released is to look at the number of business insolvencies/failures associated with the particular controller or director, and within each failure, how much of what the creditor was owed was paid out.

Profiles could be created and held with the ATO which could be tracked via director identification number which would track:

- the number of companies a director has acted for,
- whether the business collapsed, and
- the monetary amount of what was owed to creditors was received.

Recommendation #6:
That credit agencies should be enabled to compile and release profiles of defaulting directors.

New Phoenix Hotline

Maurice Blackburn is of the view that the proposed Phoenix Hotline is an excellent initiative that will make it easier for employees, creditors, competing business and the general public to confidentially provide information or report their concerns about possible phoenix activity to the ATO.

Maurice Blackburn hopes that information provided to the ATO in this way would be shared with ASIC pursuant to 2017 amendments made to s 127(a) *Australian Securities and Investments Commission Act* 2001 which allows the sharing of confidential information in connection with the performance of its functions to the Commissioner of Taxation.

Better Industry Practices and Training for Directors.

Notwithstanding that Maurice Blackburn agrees with laws that shift accountability onto directors, it also recommends that laws need be regulated to ensure better business practices and mandate rudimentary training for directors. This is in light of the onerous nature of the responsibilities on directors and other third parties.

In a recent study by researchers of Melbourne and Monash Universities, a survey was taken from members of Australian Restructuring Insolvency & Turnaround Association (ARITA)[8] and Australian Institute of Credit Management (AICM)[9] from November 2015 to February 2016 regarding phoenix activity[10].

The research results were confronting suggesting that 77 percent of respondents considered that directors of companies in liquidation 'often' have been involved as directors of other failed companies.

Maurice Blackburn is of the view that illegal phoenix activity is sometimes the product of poor management and directors being ill-qualified. Maurice Blackburn considers that more needs to be done to improve the front-end regulation of phoenix companies, including the competency requirements of directors and the tightening of regulations on entry.

There are very few requirements to become a director. Pursuant to section 201 B of the *Corporations Act.* To be a director of a company you must:

- be an individual, not a body corporate;
- be at least 18 years of age; and
- not be disqualified from managing corporations under Part 2D.6 unless the appointment is made with ASIC's permission as provided for under s 206F of the Act or leave is granted by the Court under s 206G of the Act.

Further, the only inconvenience to set up a company is far from onerous. The costs are:

- $488 to set up a public company with capital share;
- $403 to set up a public company limited by guarantee; and
- $488 for a proprietary company[11]

Finally, the application form to set up an Australian business does not require the prior corporate history of its proposed directors or any supporting evidence about the identity of the proposed directors (which can result in nominating a deceased person as a director or even an entirely fictitious character).

While there are little to no barriers to incorporating a company there are significant harmful effects on creditors in the event that a business collapses. This concern is compounded

[8] ARITA is a professional association with over 2,400 members that represents those who specialise in the fields of restructuring, insolvency and turnaround. Around 84% of registered liquidators and 87% of registered trustees are members of ARITA. They represent firms of all sizes, from small business practices through to multi-national firms. Refer https://www.arita.com.au/ARITA/About_Us/ARITA/About_Us/About-Us.aspx?hkey=ff7b83c4-fc70-4eb8-9001-08420d81582e.

[9] AICM is Australia's leading professional association for commercial and consumer credit management professionals, responsible for maximising the cash flow and minimising the bad debt risk of more than 1,300 Australian companies, including 34 of the ASX100. Refer http://aicm.com.au/about-aicm/

[10] *At the Coalface of corporate insolvency and phoenix activity: A survey of ARITA and CCIM Members* 2016

[11] 201 Application for registration as an Australian Company: https://asic.gov.au/regulatory-resources/forms/forms-folder/201-application-for-registration-as-an-australian-company

when a business person with poor business skills fails to learn from their previous corporate failures or experiences or in circumstances where they are very easily able to set up another company.

Maurice Blackburn considers that imposing compulsory business education is a valid means to combatting illegal phoenix activity. We would contend that education campaigns should not only be directed at directors but also at advisors, including lawyers, accountants, insolvency lawyers and other specialists who can be held to account for illegal phoenix activity.

Maurice Blackburn is also of the view that ASIC should obtain valid photo identification from directors when an application is made to register an Australian Company or change a director to ensure that 'straw directors' (including deceased or fictitious directors) cannot be nominated.

Recommendation #7:
That the Government consider mandating business education for directors, to improve the front-end regulation of phoenix activity.

Reforms to FEG

As mentioned earlier, the FEG is the 'scheme of last resort' which is designed to provide financial assistance to eligible employees who have lost their jobs, but have not received their employment entitlements due to the failure of the employer's business.

As the figures above confirm, there has been a heavy reliance on the FEG over the years. There is an obvious need to find a balance between providing assistance and preventing exploitation where businesses simply choose not to meet their obligations, thereby placing heavy reliance on the scheme.

An option to reduce the vulnerability of FEG to exploitation through corporate group structures would be to allow the FEG to recover benefits it has paid to redundant employees of an insolvent group member from other solvent members of that corporate group.

With such a reform, entities in a group structure would have a shared obligation to meet the unpaid employee entitlements of their related entity. This model could be premised on the current franchisor responsibility laws. Pursuant to recent legislative changes a franchisor can be held responsible for their franchisees' conduct including paying outstanding entitlements to franchisee's employers.

Recommendation #8:
That solvent entities in a group structure should have a shared obligation to meet unpaid employee entitlements of an insolvent group member.

Maurice Blackburn is also concerned about the conditions for the advance pursuant to the *Fair Entitlements Guarantee Act* 2012 (**'FEG Act'**). Namely:

1. The requirement that a person is an Australian Citizen or the holder of a permanent visa or special category visa that allows them to stay and work in Australia at the time their employment ended[12].

[12] *Fair Entitlements Guarantee Act* 2012 s10(1)(g)

Maurice Blackburn submits that the eligibility criteria for the FEG unnecessarily disqualifies temporary visa holders from accessing government assistance in circumstances where the employer liquidates the business through no fault of the worker. As mentioned earlier, many of the victims of illegal phoenix behaviour are from immigrant, migrant and student backgrounds.

2. The cap placed on recovery:
    a. Unpaid wages - up to 13 weeks;
    b. Payment in lieu of notice - up to 5 weeks[13];
    c. Redundancy pay - up to 4 full weeks per full year of service[14]

Placing caps on the advance results in employees being unable to recover the amounts they are owed.

Another important consideration is that many victims in this circumstance may require reskilling and retraining to return to the workforce. Arguably, provisioning a larger advance (to which the employees are entitled) would provide them with better means to reskill and retrain.

Recommendation #9
That eligibility criteria for an advance under FEG be adjusted to remove the requirement that a person is an Australian Citizen or the holder of a permanent visa or special category visa.

Recommendation #10
That caps on FEG advances be removed.

[13] Ibid s22
[14] *Fair Entitlement Guarantee Act* 2012 s23(b)