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

Dear James

Combatting Illegal Phoenixing – submission

As you know, I gave my comments on these proposals at an earlier meeting. Thank you for that opportunity.

My comments now will briefly re-state my views, and give ratings and some answers to your questions. However, I can add more, informally or otherwise, later. My present difficulty is the large amount of information available that goes to your questions such that it is impractical for me to attempt to summarise and assess for the purpose of this submission. It may suffice to bring it to your attention if you are not already aware of it.

On my brief review, concerns about phoenix activity, and in some cases recommendations for reform, come up in the Productivity Commission Report No. 84—Shifting the dial, of 3 August 2017; the regular Parliamentary Joint Committee on Corporations and Financial Services - Oversight of ASIC and the Takeovers Panel of 11 August 2017, ASIC's annual report 2016-2017, and that of the FWO, in the Joint Standing Committee on Foreign Affairs, Defence and Trade on Adopting a modern slavery act in Australia, 2 August 2017, in other recent Senate reports and recommendations, and in recent case law. You will be aware of these and I make some reference to them but can discuss further if you wish. You will also be aware that New Zealand is itself considering anti-phoenix reform.

I particularly draw your attention to the all pervasive reach of phoenix misconduct, in evidence on 2 August 2017 before the JSC on modern slavery from Ms Maksimovic of the ACTU about the need for a modern slavery law.

> "… it raises awareness. Part of that awareness will be about companies having to disclose what they are doing to make sure that consumers and civil society groups can be reassured that they are doing the right thing. That is not something that exists in our current laws. If you talk to the Fair Work Ombudsman people they will tell you that there have been a number of companies that they have fined numerously. It does not stop them.
>
> … we need to act in relation to those companies who keep breaking the rules. Sometimes it is much cheaper for them to do this if they are companies that make a lot of money, if they are companies that can do things like phoenix.

> They can just shut themselves down and reappear again by going bankrupt and so on. …
>
> Senator Gallacher: Transparency would make these companies visible to either the end user or the product line, so to speak.
>
> Ms Maksimovic**:** Yes. Transparency is really important. That is the biggest reason to have the modern slavery act, because we just do not know what is going on. It is really hard. We have worked on FOIs and we have tried to work with registries et cetera, but we do not have the resources to do this necessarily. Often it is really not possible to find out what is happening because of the way that companies are now constructed, where there is a very complex set of subsidiaries and labour hire. There is a whole range of these things. This is why companies are saying, 'We use this, this and this with different names.' We can then actually say, 'Okay, everything is all right here,' or, 'Things are not right here.'

I will refer to this evidence again in this submission.

I have high regard for the Melbourne Monash Phoenix Reports[1] and generally support those recommendations. Some of these generally accord with various views expressed by myself and A/Prof Jason Harris in our text book[2] and other writings and discussions, to which I will refer.[3] However these comments are my own.

The business and corporate environment

As I explained, drawing broadly on the discipline of environmental criminology, the law must give attention to the landscape in which phoenix activity (and other corporate defaults generally) exists. The terms transparency, 'sunlight' and open access to information sum up themes of law reform that are necessary. Unless and until that corporate environment is improved, the issue with phoenix misconduct will continue to exist.

As the modern slavery transcript says,

> "transparency would make these companies visible to either the end user or the product line, so to speak. … Yes. Transparency is really important. That is the biggest reason to have the modern slavery act, because we just do not know what is going on. It is really hard".

First priority – proactive and disruptive measures

The first priority therefore is to establish that open accessible corporate environment that serves as a disruptive and a preventive factor against what is in many cases opportunistic misconduct or crime.

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[1] Regulating Fraudulent Phoenix Activity

[2] *Keay's Insolvency*, Murray & Harris, Law Book Co, 9th ed, 2016

[3] For example, *What do we expect of insolvency and of insolvency practitioners*? Jason Harris and Michael Murray, INSOL International – Academics' Colloquium, The Hague 18-19 May 2013. I represented the IPA (now ARITA) at that session.

Reforms needed are director biometric identification, open access to ASIC data,[4] access to details of beneficial ownership, and payment of employee taxes by way of single touch payroll. There are other landscape options beyond these.

I note that several of these are not including in your options for reform.

Nevertheless, I give ratings of 6-10 for your various reform items in this proactive category.

The second priority – reactive ex post enforcement

The second priority is to have measures that serve to enforce the misconduct that occurs regardless, both for the purpose of recovery of moneys, if possible, and for the purposes of general and specific deterrence. Such laws are necessary but are invariably promoted as being of first priority, which they are not.

I give ratings of 1-5 for your various reform items in this category.

1. A phoenix hotline - four

A hotline might be useful but the operator of it should be independent of any of the major players – ATO, ASIC, DE etc. Despite the appearance of co-operation, the silo mentality of some or all government (and private) agencies would be an inhibiting factor.[5] The obvious lack of communication between agencies in the implementation of the ILRA 2016 is an example.

AFSA would be a worthy agency to be given this task. Its ability to manage proceeds of crime, PPS and Commonwealth trustee roles, as well as bankruptcy, supports this view.

However, you should take into account the fact that phoenix misconduct is difficult to define and assess. The PJC hearing on 11 August 2017 heard from Mr Day of ASIC that "the level of understanding of what is phoenix activity in the community is quite low" and that creditor accusations have been made of "deeds of company arrangement, which are appropriate workouts under the Act".

That is, the hotline may create unrealistic expectations. Again, AFSA has managed this in bankruptcy through its useful pre-referral inquiries facility for offences.

2. A phoenixing offence – seven

My allocation of a rating of seven is on the basis that if such an offence is created, you may have difficulty in its definition. The Melbourne Monash Phoenix Reports rate this low for reasons the team gives and I agree. Another option you raise is to designate breaches of existing provisions as phoenix offences, which may assist.

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[4] The modern slavery transcript records "we have worked on FOIs and we have tried to work with registries et cetera, but we do not have the resources to do this necessarily".

[5] See *Innovation in the Australian Public Service: A Qualitative Analysis* - Wipulanusat, Panuwatwanich and Stewart, Griffith University, 2017, p 157ff.

At the same time, the use of a process like s 139ZQ Bankruptcy Act would be worthwhile, if it could be attached to some sufficiently useful definition. Jason Harris and I have at various times raised this idea,[6] but in the broader context of the use of such notices for challenging voidable transactions generally, as in bankruptcy. We continue to support this.

AFSA could advise you on the efficacy of s 139ZQ notices, which I understand to be good. The notices might need to be tempered by removing the criminal liability for non-compliance. They should only be issued through ASIC.

When you mention deterrence, you will be aware that reliance on expectations of general deterrence is problematic, because it depends on prompt regulatory action, and outcomes, which do not seem feasible. Disruption is a valid focus, accepting that no crime can ever be fully prevented.

I refer you to very good evidence from criminologists given to a recent Senate Committee inquiry, and its report of 23 March 2017 titled '*Lifting the fear and suppressing the greed': Penalties for white-collar crime and corporate and financial misconduct in Australia*.

3. Addressing issues with directorships - six

A rebuttable presumption, consist with Commonwealth prosecution guidelines, seems appropriate. I make no particular comments beyond that and allocating the rating.

The whole circumstance of companies being abandoned needs attention. This is dealt with in the Melbourne Monash Phoenix Reports, including ASIC's limited reporting of these companies.

It is all a consequence of the lack of a government liquidator, the lack of director identity requirements, the lack of funding (say by way of a levy on company registration), and the legal deficiencies you have identified.

4. Restrictions on voting rights - three

I have mentioned to you what I think is a potential for abuse of s 90-35 of the Schedules in the way the sections are drafted. I make no particular comment beyond that and the allocation of the rating.

5. Promoter penalties - six

I make no particular comments beyond the rating.

6. Extending the Director Penalty Notice Regime to GST - seven

I have raised this at various times over the years. There may be policy reasons why it is not included in the DPN regime. Subject to any such tax law or policy reasons, I agree it should be included.

[6] See *Keay's Insolvency*, chapter 21.

7. Security deposits - five

I note these do not appear to have been much used. I make no particular comment beyond that and the allocation of the rating.

8. Targeting higher risk entities - six

I have noted your comments about the difficulties and see this as preventive and disruptive measure. But it still requires a proactive response by the ATO which may not be feasible.

In any event, I note the government has announced reforms to the ATO's recovery powers, "including strengthening director penalty notices and use of security bonds for high-risk employers", in the unpaid superannuation context.

I make no particular comment beyond that and the rating.

9. Appointing liquidators on a cab rank basis - six

You are raising this as a particular process in relation to HREs. This may be a useful measure although the process would need some attention.

You will note ASIC's comments on this and its reference to overseas experience.[7] I suggest you ask for a copy of the briefing paper if you do not already have it.

I am familiar with alternate bases of selection of practitioners in Europe, not for the purposes you raise, but to secure the perception of independence than can be challenged when the practitioner is chosen by the directors. Several EU countries adopt randomised computer based methods of appointment. If you need more detail, including in the Australian context,[8] please let me know.[9]

I have already mentioned what I see as the potential for abuse in the removal of liquidators, and trustees, under s 90-35 of the Schedules.

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[7] Mr Medcraft**:** … there was a report in the UK last year on looking at this whole issue of small-bank insolvencies … Basically, you have a fixed price so that you can't what I call 'rob the grave'. Mr Falinski: And they were also talking about a cab rank rule. Mr Medcraft**:** They were—a cab rank rule. We could share that, if you haven't seen it, with you. That might give you some ideas. It was quite interesting, because at the big end it's many things the government has announced, in dealing with large issues, but at the small end it's often this problem. And how do you deal with this problem I'm talking about? There's a cab rank rule and a fixed price. I'd suggest that we send you this, perhaps with a little briefing—John? Mr Price**:** Yes, we can certainly do that.

[8] See for example *CBA v Fernandez* [2010] FCA 1487

[9] See *European Insolvency Law - Reform and Harmonization*, Keay *et al*, Edward Elgar 2017.

A Government Liquidator - ten

Australia's regime lacks a government role in relation to corporate insolvency, in contrast to other comparable jurisdictions. Jason Harris and I have presented on this topic internationally[10] and in our textbook.

Insolvency inherently needs a government role given the limited funds available, or in many cases, no assets, often by design. The private market necessarily relies upon assets from which to draw remuneration. The lack of a government liquidator only adds to the problem of abandoned companies. Abandonment is often the only real option for a director without assets in the company or personal funds. You will be aware of the figures given by the Melbourne Monash Phoenix Reports on abandoned companies.

While it might be said that it is the creditors who should fund liquidations, either from remaining assets available, or from their own funds, that is a based on a narrow and invalid view of the purpose of insolvency, from economic, social, and business perspective. If you need me and A/Professor Harris to explain more, please let me know.

10. Removing the 21 day waiting period for a DPN - eight

I make no particular comment beyond the rating.

11. Providing the ATO with the power to retain refunds - eight

I make no particular comment beyond allocating the rating.

Further comments

Data

The Melbourne Monash Phoenix Reports refer to the team's difficulties in finding consistent data, including from the ATO and ASIC. At the recent PJC inquiry, on 11 August 2017, ASIC reported that it

> "targets directors for surveillance who have had a history of involvement in failed companies, where there have been allegations of illegal phoenix activity. We actually use external data to help our risk targeting in that regard".

At the Senate inquiry into ASIC in 2014, at the request of the inquiry for a statement of what statistical research data was needed in Australia, a number of insolvency academics, including Professor Harris and myself, put forward a detailed submission on what statistics were required. Somewhat to our chagrin, the resulting Senate report made no comment on this submission, or otherwise. We note that Senate inquiries continue to ask for good data.

[10] *What do we expect of insolvency and of insolvency practitioners*? Jason Harris and Michael Murray, INSOL International – Academics' Colloquium, The Hague 18-19 May 2013. I represented the IPA (now ARITA) at that session.

The government also rejected 2010 Senate report recommendation 17, to establish a "unit responsible for gathering, collating and analysing data on a range of corporate and personal insolvency matters". Importantly, "there should be no charge for accessing that data". That could be reconsidered. I suggest that AFSA has the appropriate expertise.

I would only offer any further comments by phone.

As the modern slavery transcript records,

> "… transparency is really important. … we just do not know what is going on. It is really hard. We have worked on FOIs and we have tried to work with registries et cetera, but we do not have the resources to do this necessarily. Often it is really not possible to find out what is happening because of the way that companies are now constructed, where there is a very complex set of subsidiaries and labour hire. There is a whole range of these things".

Review of the law

I have previously suggested that reform legislation require the operation of the new law to be reviewed and reported upon. I am pleased to see this implemented in s 588HA of the Corporations Act, in relation to safe harbour and s 588GA.

I suggest that approach be adopted here.

More?

If you need more, or to discuss, please contact me.

Details of my qualifications and experience that go to support this submission are attached.[i]

Yours sincerely

M Murray

Michael Murray

[i] Michael Murray, LLB, Dip Crim, FAAL. Visiting Fellow, QUT Law Faculty. Writer, *Murrays Legal Commentary*. Bankruptcy Act committee member. Author, *Australian Insolvency Management Practice*, CCH; co-author, *Keay's Insolvency* (with Jason Harris). Member: ARITA (hon), INSOL International, INSOL Academics, Banking and Financial Services Law Association. Fellow and Director, Australian Academy of Law.