



PITCHER PARTNERS

ACCOUNTANTS • AUDITORS • ADVISORS

Level 19
15 William Street
Melbourne
Victoria 3000

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

Level 1
80 Monash Drive
Dandenong South
Victoria 3175

Tel: +61 3 8610 5000
Fax: +61 3 8610 5999
partners@pitcher.com.au
www.pitcher.com.au

B J BRITTEN
M W PRINGLE
D A THOMSON
M J LANGHAMMER
M C HAY
V A MACDERMID
P A JOSE
M J HARRISON
T SAKELL
G I NORISKIN
K L BYRNE
S D WHITCHURCH
D J HONEY
G J NIELSEN
N R BULL
A M KOKKINOS
G A DEBONO
F V RUSSO
A T CLUGSTON
M G JOZWIK
B POWERS
K J DAVIDSON
J C CHENG
M DAWES
M J WILSON

R RIGONI
G M RAMBALDI
D A KNOWLES
J BRAZZALE
S SCHONBERG
S DAHN
A R YEO
P W TONER
D R VASUDEVAN
A T DAVIDSON
C D WHATMAN
A E CLERICI
P MURONE
A D STANLEY
D C BYRNE
P B BRAINE
R I MCKIE
M R SONEGO
S J DALL
D W LOVE
A SULEYMAN
D R DOHERTY
J L BEAUMONT
B A LETHBORG

27 October 2017

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

By Email: phoenixing@treasury.gov.au

Dear Mr Mason

Combatting Illegal Phoenixing - September 2017

Feedback and Comments

Enclosed is a submission made by Pitcher Partners Business Recovery and Insolvency Services regarding the law reform proposals set out in the 'Combatting Illegal Phoenixing' Consultation Paper.

Also enclosed is a short profile on Pitcher Partners. The submission is made by me in my capacity as the Chairman of the National Pitcher Partners Insolvency and Reconstruction Services practice, which is made up of Pitcher Partner Insolvency Practices based in Melbourne, Sydney, Adelaide and Perth.

If you have any queries regarding our submission, we would welcome the opportunity to discuss it with you.

Yours sincerely



Gess Rambaldi
Chairman
National Business Recovery and Insolvency Services

Encl

Ref: GMR | I.371324.1

ABOUT PITCHER PARTNERS

Pitcher Partners is a full service accounting and business advisory firm with a strong reputation for providing quality advice to privately-owned, corporate and public organisations.

In Australia, Pitcher Partners has firms in Adelaide, Brisbane, Melbourne, Perth, Sydney and Newcastle. We collaboratively leverage from each other's networks and draw on the skills and expertise of 1,280+ staff, in order to service our clients.

The National Pitcher Partners' Business Recovery and Insolvency Services Practice (the National BRI Practice) is comprised of the four Pitcher Partners BRI Practices that operate out of Pitcher Partners offices in Melbourne, Sydney, Adelaide and Perth. The National BRI Practice has extensive resources and provides corporate and personal insolvency services through its many registered Liquidators and Trustees in Bankruptcy and their respective staff across all of Australia in a wide range of industries.

PHOENIX HOTLINE

QUESTIONS

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.

Pitcher Partners are of the opinion that this measure will be ineffective in the event that the hotline operator is not sufficiently resourced and trained to adequately record, investigate and deal with referrals to the hotline. This measure will be moderately effective in the event that the hotline operator is sufficiently resourced and trained to adequately record, investigate and deal with referrals to the hotline.

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

Avenues currently exist under ss533, 422 and 438D of the Corporations Act 2001 (CA) for external administrators to report illegal phoenix activity to ASIC. Unfortunately, lack of resourcing within ASIC has resulted in a significantly low number of reports alleging misconduct being referred for further investigation, or compliance (refer ASIC's Annual Report 2015/16).

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

Benefits	Risks
The early potential identification of phoenix operators and activities.	An insufficiently resourced or inexperienced hotline operator unable to monitor the hotline, analyse data and investigate the referrals.
The identification of an increased number of phoenix operators and activities.	The consequential loss of faith in the hotline service, the operator and the investigative and prosecutorial system.
The early (or earlier) intervention of phoenix offences and activities.	The receipt of numerous incorrect, malicious, misleading and false referrals.
The ability to gather information from numerous sources and the generation of a significant bank of potential offence data.	
The ability to share the information across relevant government agencies.	

4. Which agency do you believe would be best placed to operate such a hotline?
 - The Australian Taxation Office appears to be best placed to operate the hotline.
 - ASIC does not appear to be currently well placed to operate the hotline, even though it is the regulator of companies.

5. What public reporting would be appropriate to ensure transparency? What other mechanism could be considered?
- The public reporting should include the publication of detailed statistics regarding:
 - the number of referrals to the hotline;
 - the action taken to investigate the referrals by category of referral;
 - the number of active investigations;
 - the number of active prosecutions;
 - the number of successful and unsuccessful prosecutions and the penalties imposed.

Phoenixing Offence

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

Pitcher Partners regards the measures identified in this section to be potentially highly effective.

The following submission is provided in response to questions 7 to 16 inclusive.

The proposal is to do the following:

- Introduce a specific phoenix offence styled on s.121 of the Bankruptcy Act 1966 (BA).
- Include a 'deemed intention' provision such that a transferor will be taken to intend to defeat creditors if it can be inferred that the transferor was insolvent at the time of the transfer.
- Allow liquidators and creditors to sue for those knowingly engaged in the conduct for compensation for loss.
- Introduce a compulsory notice regime procedure similar to s.139ZQ of the BA.

Pitcher Partners – Melbourne operates one of Australia's largest personal insolvency practices. It has considerable experience in using the voidable transaction provisions of the BA and the various investigative and compulsory notice provisions of the BA. It is one of the largest users of compulsive notices under the provisions of the BA in Australia.

Pitcher Partners supports the introduction of a specific phoenix offence styled on section 121 of the BA. We believe that these provisions will be highly effective if:

- The provisions include a 'deemed intention' to defeat the interests of creditors if the transferor was, or was about to become insolvent at the time of the transfer.
- Other 'deemed intention' examples which identify circumstances particular to phoenix activity are included in a 'deemed intention' provision.
- The ASIC, liquidator and creditors (with the liquidator's consent) will be entitled to take direct action against the transferee entity to have a transfer declared void.
- A compulsory notice regime procedure similar to s.139ZQ of the BA is concurrently introduced (see below). We believe the compulsory notice regime provisions (and other provisions) will assist external administrators in obtaining evidence when investigators suspect phoenix transactions (see below).

Deemed Intention Provisions

We recognise the difficulty in distinguishing between those who are engaged in illegal phoenixing activity and those who are 'simply involved in a failed economy' (refer Forward to *Controlling Illegal Phoenix Activity Discussion Paper September 2017*) (the Phoenix Discussion Paper).

Honest or legitimate business rescue as that term is defined in the Phoenix Discussion Paper, 'is a legitimate use of the corporate form, whereas illegal phoenixing is a misuse of the corporate form, which seeks to exploit the privilege of limited liability.' We agree with the commentary in the

Phoenix Discussion Paper that the difference between illegal phoenixing and honest business rescue activities ‘...largely hinges on the question of whether the company’s controller’s intent is genuine and honest or illegitimate – namely to avoid payment of liabilities. This is difficult to prove to the requisite legal standard.’

In our view, the provisions of subsection 588FE(5) of the CA which may be used to void a transfer of property with the main purpose being to prevent, hinder or delay the process of that property becoming available for creditors, are deficient in that the provisions do not incorporate the ‘deemed intention’ provisions currently provided in subsection 121(2) of the BA, namely, that the main purpose will be taken to be the purpose prescribed by the provision (for example, an intention to defeat the interests of creditors) if it can reasonably be inferred at the time of the transaction, the company was insolvent. In addition to this ‘deemed intention’ and/or ‘inferred purpose’ provision, the ‘inferred purpose’ provision could be extended to incorporate circumstances that are common to illegal phoenix activity, for example, transactions which:

- do not provide for goodwill in circumstances where substantially the same business continues to trade post the transaction; and/or
- a significant portion of the consideration concerns the assumption of related party liabilities; and/or
- an insignificant component of the consideration is constituted by cash; and/or
- vendor’s terms are provided which are significantly at variance to the terms that would be payable in the market by a third party acquirer; and/or
- the values attributable to the assets used by the business do not reflect ‘going concern’ values even though the same or essentially the same business is continued by the purchaser.

Evidentiary Issues – Additional Powers Required

Liquidators and bankruptcy trustees encounter evidentiary difficulties when investigating and pursuing suspect phoenix transactions. These evidentiary difficulties frustrate the timely and cost effective investigation of suspected phoenix transactions.

There are significant differences in the ability of liquidators and trustees to compel the production of information from entities, other than the insolvent. This part of our submission addresses additional measures which should be introduced to support the investigation and pursuit of the phoenix offence.

Evidentiary Issues – Books of Associated Entities

Evidence of a phoenix transaction and offence may be contained in the books of an associated entity (for example, the transferor).

A liquidator has a limited ability to require an associated entity of the insolvent company to produce books of the associated entity to the liquidator. A liquidator can only compel the production of books of associated entities using the examination power set out in s.596B of the Corporations Act. This process is costly and will require the liquidator to engage external lawyers to pursue the examinations through the Supreme or Federal courts. In assetless administrations, these costs often prove to be prohibitive.

Pursuant to s.77A of the BA, a bankruptcy trustee can serve a notice on a person in possession of books of an associated entity of the bankrupt, requiring that person to produce those books to the trustee, if they are relevant to the bankrupt’s examinable affairs. A person who refuses or fails to comply with a Notice without a reasonable excuse commits an offence (s.265A of the BA). The trustee can serve a notice in the exercise of their discretion and with limited cost. The regulator has no involvement, save for the prosecution of the offence.

No comparable power or offence exists under the CA. Any phoenix offence reform should examine the introduction of compulsion process similar to s.77A of the BA. As with the BA, the power to issue a s.77A type notice should be retained by the external administrator.

Evidentiary Issues – Compulsory Production and Examination by Regulator

Evidence of a phoenix transaction and offence may be in the possession of a person who does not meet the definition of an ‘associated’ entity.

Pursuant to s.77C, the AFSA can issue a notice (s.77C notice) to any person requiring them:

- to give information relating to the performance of the bankruptcy trustee’s functions
- to give evidence relating to the performance of the bankruptcy trustee’s functions
- to produce books in the person’s possession relating to the performance of the trustee’s functions.

Section 77C notices are issued by AFSA at the request of the bankruptcy trustee. A s.77C notice, in reality:

- requires the person named to provide information and books relevant to the trustee’s investigations to AFSA, who will in turn provide them to the trustee; and
- requires the person to attend AFSA’ offices for a compulsory interview, conducted on oath and by the trustee under the supervision of AFSA. This interview is tape recorded and a copy retained by AFSA, the trustee and the interviewee.

It is an offence to fail to comply with a s.77C notice.

There is a modest fee payable by the trustee to have the s.77C notice issued by AFSA. Service of the notice and the enforcement of compliance is the responsibility of AFSA once issued. The s.77C notice procedure is a powerful investigation tool available to bankruptcy trustees.

No comparable power or offence exists under the CA. Any phoenix offence reform should consider the introduction of a compulsory document production and interviews conducted by the regulator, similar to s.77C of the BA.

We must also stress while the preference would be for ASIC to be given the responsibility of issuing the equivalent of the s.77C notice, support is predicated on ASIC having administrative, professional and sufficient resources necessary to facilitate the proper, effective and timely issuance of the s.77C type notices. In the absence of this, the issuance of such notices could be given to the external administrator.

General Comments – s.139ZQ style notices

- In respect to the s.139ZQ style notice, we believe that ASIC, as the regulator of companies, should retain control of issuing such notices. We are not opposed to the suggestion that certain, specific bodies, such as FEG or the ATO be empowered to issue comparable notices.
- The s.139ZQ style notice should take effect on receipt (i.e. there should not be any period of notice).
- Subject to ASIC being properly resources, liquidators should not be empowered to issue s.139ZQ style notices.
- The proper remedy for an aggrieved recipient of the s.139ZQ style notice should be an application to court to set the notice aside.
- Liquidators should be empowered to issue notices akin to s.77A notices under the BA.
- Subject to ASIC being properly resourced, ASIC should be empowered to issue notices akin to s.77C notices under the BA.

REMEDIES

QUESTIONS

17. Are these remedies appropriate? Are there further remedies or penalties we should consider?
18. If the above amendments are made, should the law also be amended to include a specific provision to the effect that knowing involvement in a contravention of the provision will itself constitute a contravention of the provision (as per sections 181 — 183 of the Act)?
19. What tests can be applied to determine if a person has been involved in the facilitation of illegal phoenix activity?

The following submission addresses questions 17 to 19 inclusive.

The Government is considering whether:

- liquidators and ASIC should be able to claw back assets or compensation from transferees of property;
- liquidators, ASIC and creditors should be able to pursue compensation for loss caused by illegal phoenix activity from directors of the transferor, the transferee and others who are knowingly involved in illegal phoenix activity; and
- civil and criminal penalties should apply to illegal phoenix activity, including those who are knowingly involved.

The Corporations Act currently contains provisions which are capable of providing these outcomes. A failure to achieve these outcomes under current law mostly arises through a combination of:

- insufficient resourcing of ASIC to properly investigate and pursue civil and criminal action against wrongdoers;
- ASIC's apparent inability to adequately prioritise and resource the investigation and prosecution of criminal conduct;
- insufficient funding of liquidators to investigate and pursue wrongdoers; and
- an absence of proper communication, co-ordination and formulation of strategy between ASIC, ATO, the Director of Public Prosecutions (DPP) and liquidators concerning the investigation and prosecution of criminal conduct.

For some deliberately impecunious illegal phoenixing operators, the threat of compensation orders is meaningless and has no deterrent effect. They are likely to have taken steps to ensure they do not have personal ownership of assets and/or appropriate steps to minimise personal risk. Liquidators and creditors may obtain compensation orders against this small group of operators which will never be satisfied through ordinary debt recovery processes. Bankruptcy may often be the only option.

In these instances, and across the corporate sphere, the imposition of significant criminal penalties will have a deterrent effect if:

- proper referrals of potential criminality are adequately investigated by ASIC;
- criminal conduct is consistently and adequately prosecuted;
- the communication and co-ordination of the investigation and prosecution of criminal conduct between ASIC, ATO, DPP and liquidators is comprehensively reviewed and reformulated;
- liquidators were empowered to refer criminal conduct directly to the DPP for prosecution in certain circumstances. Provisions to this effect exist in the Corporations Act which appear to be rarely used by liquidators.; and
- penalties for criminal conduct are reviewed and increased.

DESIGNATING BREACHES OF EXISTING PROVISIONS AS PHOENIX OFFENCES

QUESTIONS

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.

Pitcher Partners rates this measure has having a moderate to good prospect of being effective.

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

The following submission addresses question 21.

The Government is considering whether:

- breaches of CA provisions, namely a failure to maintain adequate books and records and a failure to provide them to a liquidator in a formal insolvency will be made 'designated phoenix offences'. Instances of a breach could result in a director being deemed a Higher Risk Entity; and
- knowing involvement in a contravention of a phoenixing provision would constitute a contravention of the provision.

Phoenix Activity Behaviour and Circumstances

Although laws currently exist which may be used by external administrators to address 'illegal phoenix activity', we are of the view that the specific circumstances surrounding the use of illegal phoenix activity, and the significant cost to the Australian economy of the continued use of 'illegal phoenix activity' warrants a review and modification of existing laws. While not all phoenix activity is the same, our experience in dealing with phoenix activity over a considerable period of time and in a vast number of external administrations and industries, demonstrate the existence of common behaviours and/or circumstances. The most common behaviours or circumstances around phoenix activity include the following:

- A transfer of business and assets for less than market value.
- Actual or impending insolvency.
- The transfer of the business and assets to an entity controlled by the controllers of the vendor entity.
- Creditors not essential to the continued operation of the new entity are 'left behind'.

Where advisors or facilitators are involved, common behaviours or circumstances in phoenix activity include:

- the existence of a 'facilitator' and/or advisor who coordinates or 'directs' the legal transfer of ownership; and/or
- the payment of upfront and/or above market fees for the services of the facilitator; and/or
- the replacement of existing financiers providing finance facilities at prevailing market rates to 'third' and 'fourth' tier financial providers well above market finance facilities.

The designation of a person as a Higher Risk Entity (HRE) has a number of implications addressed later in these submissions. A designation as an HRE is a precondition to a subsequent designation as a High Risk Phoenix Operator (HRPO) by the Deputy Commission of Taxation (DCT), but has no other immediate consequences. The proposed consequences of a designation as an HRPO by the DCT include:

- A restriction on choice of the appointment of a liquidator to an HRPO, the liquidator being appointed on a Cab Rank basis.

- An immediate personal liability for tax set out in a Director Penalty Notice (as opposed to a 21 day period).
- The retention of tax refunds due to the HRPO.

Whilst we address these issues later in this submissions, we are not opposed to the introduction of the HRE and HRPO regime, but we are opposed to the cab rank appointment of liquidators.

The failure to maintain adequate books and records currently carries a number of consequences, including a statutory presumption of insolvency in certain proceedings. Non-compliance with the provisions of subsections 530A and 530B (director's obligation to deliver books and records to a liquidator) and the requirement of the company to keep written financial records under s.286 of the CA significantly affects the ability of a liquidator to investigate and pursue actions to remedy illegal phoenix activity.

We support the creation of a designated phoenix offence where there has been a breach of the aforementioned sections **and** the liquidator has formed the view that a prescribed number of the abovementioned behaviours or circumstances of phoenix activity have been established. We also advocate that where it is established by the liquidator that the circumstances surrounding the illegal phoenix activity have identified a phoenix facilitator having involvement in the contravention of a phoenix provision, knowing involvement in a contravention of a phoenix provision by the facilitator or advisor would also constitute a contravention of the provision by the facilitator or advisor.

We note the government has submitted in the discussion paper a proposal that would identify and declare a person to be a HRPO where the person is found to have committed a phoenix offence. We support the introduction of the HRE and HRPO regime, and support the introduction of a designated phoenix offence and an offence of knowing involvement.

We otherwise repeat our submission in response to questions 17 to 19 above regarding the adequacy and resourcing of the investigation and prosecution of offences.

LIMITING BACKDATING OF DIRECTOR APPOINTMENTS AND RESIGNATIONS

QUESTIONS

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.

Pitcher Partners rates this measure as having a good to high rate of effectiveness.

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?

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

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

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?

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

The following submissions address questions 23 to 27 inclusive.

The Government proposes to do the following:

- Include a rebuttable presumption that in circumstances where a change of director notice is lodged more than 28 days after the date of the purported resignation, the director could still be held liable for misconduct that occurred up to the point of lodgement.
- The presumption could be overturned by a court or by ASIC.

- The onus for reporting director resignations could be shifted from the company to the individual director.

Pitcher Partners has extensive experience in investigating serious illegal phoenix activity. In a significant proportion of our investigations, the backdating of director appointments and resignations, and their general misuse, is one of the common tools used to facilitate illegal phoenix activity.

We strongly support the introduction of a rebuttable presumption in these terms. The presumption should operate on the basis that the director continued to act as a director throughout the period prior to lodgement of the resignation. This would allow ASIC and a liquidator to hold a director to account for all of a director's duties through this period, which may or may not involve allegations of misconduct.

The individual director should bear the onus for reporting their appointment or resignation to ASIC.

A 14 day period is reasonable to allow for the requisite notice to be lodged with ASIC.

The presumption should be capable of being overturned by a court.

The measure does not need to be enforced per se. The presumption would apply for the benefit of ASIC, liquidators and creditors in court proceedings brought against the director.

ABANDONING COMPANY

QUESTIONS

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.

Pitcher Partners rates this measure as having a good to high rate of effectiveness.

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

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

31. Should abandoning a company instead be an offence?

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

33. What other options are available for consideration?

The following submission addresses questions 29 to 33 inclusive.

The Government proposes to limit a sole director's ability to resign from office without first finding a replacement or winding up the company's affairs. A similar restriction would apply to two or more directors attempting to simultaneously resign.

We wholly support this proposal. It is an absurdity of our regulation of corporations that a company can be allowed to exist without a current director. It should not be allowed.

We cannot discern of any risks arising from this proposal.

It should not be an offence to abandon a company. The cost and administrative burden of prosecuting this offence outweighs any benefits in doing so. It is far simpler to prohibit the resignation in the first instance.

A company with no director for a prescribed period should not be automatically deregistered. There may be assets, or misconduct which should warrant investigation. The automatic deregistration of such companies creates an incentive for sole directors to resign, knowing that

automatic deregistration will follow. Companies with no directors should be wound up by ASIC using a streamlined procedure.

RESTRICTIONS ON RELATED PARTY VOTING

QUESTIONS

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.

Pitcher Partners rates this measure as having a moderate rate of effectiveness.

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

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

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

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

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

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.

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

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

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

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

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

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

The following submission addresses questions 35 to 46 inclusive.

We have identified the following benefits and risks in respect of restricting related party voting regarding resolutions to replace the liquidator:

Benefits	Risks
There would be greater confidence in the system as concerns that an allegedly phoenixed enterprise and its proprietors will avoid scrutiny would be alleviated to an extent.	The proposed measure will increase expectations of phoenix transactions being prosecuted, the occurrence of which will still be influenced by other factors such as the existence of funding and willingness of regulators to take action.
The greater potential for a phoenix friendly liquidator to be replaced would discourage the practice of phoenix activity.	For liquidations where phoenix transactions are not an issue and related party intentions are genuine, the opportunity for militant creditors to appoint replacement liquidator increases.
	Greater effort will be undertaken by pre-insolvency advisors to take disingenuous steps to change the classification of a creditor from related to non-related including, but not limited to, a purchase of debt and/or debt assignment.

As a general principle, related parties should not be able to influence the choice of external administrator at the expense of the wishes of non-related party creditors. Even though the majority of related party debt is legitimate, in the interest of transparency and to have confidence in the system on the issue of choice of removal and replacement of an external administrator, control in respect of the replacement of a liquidator should rest with non-related party creditors.

The efficacy of the proposal will be influenced by the ability of the external administrator to identify and verify a creditor related status.

Pitcher Partners does not agree with a proposal of disregarding related party votes for all resolutions. Subject to adequate proof being provided as to the existence of a debt, a related party should have the same rights as all other creditors. The existence of related parties can have a beneficial influence on the efficient function of an insolvency administration in a practical sense. The most obvious example is where the insolvent entity has no creditors other than related parties and resolutions are still required for the appointment of a liquidator or to approve such resolutions as the liquidator's remuneration. But even where there are non-related party creditors that are significant in number and value, liquidators must often deal with creditor apathy and become more reliant on related party participation in such circumstances.

Companies can appoint replacement 'dummy' directors and members which is a common tactic applied by rogue pre-insolvency advisors, most commonly to provide phoenix business transfers with the illusion of being at arms-length. Where a directorship appointment change is backdated it can be abused as a defence to any potential insolvent trading claim.

We are aware of tactics used by phoenix facilitators to turn a company from a related party creditor to a non-related party creditor with the stroke of a pen. For example, the appointment of a replacement dummy director and the transfer of shares to a trustee company may convert a

'related entity' to a non-related entity. Deterrence through increased penalties for such practices would be one possible remedy to this practice.

Unfortunately, we have seen examples of liquidators colluding with related party creditors. Fortunately, this represents a very small percentage of liquidators. Most liquidators take the greatest care and attention to ensure they perform their duties in a careful, independent and unbiased manner.

For those renegade minority liquidators that are not doing the 'right thing', the law should be amended to allow for their inclusion as a person who may be knowingly involved in illegal phoenix activity and therefore be subject to compensation for the loss incurred by the illegal phoenix activity.

PROMOTER PENALTIES

BROADENING DEFINITION, ADDING NEW LIMIT, CREATING NEW PROVISION

QUESTIONS

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.

Pitcher Partners rates this measure as having a moderate rate of effectiveness.

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

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

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

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

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

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

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

The following submission addresses questions 48 to 54 inclusive.

Pitcher Partners broadly supports any amendments that would facilitate the disruption of the phoenix business model adopted by facilitators. We caution however whether Options Two and Three, that involve changes to the law, will achieve the desired results and discourage phoenix activity unless there is an accompanying increase in resources necessary to prosecute the offences. Currently resources are lacking in this area. The CA provisions that discourage aiding and abetting of directors breaching their duties already exist and, in our view, are not pursued by liquidators as frequently as desired due to the lack of funding and the risks associated with litigation.

Prosecuting and discouraging Phoenix promotion is often an issue of resources and enforcement rather than deficient penalties or legal framework. This is not to say, however that legislative reform is not needed. In fact, the opposite is often the case. In circumstances where considerable hurdles are faced by liquidators in respect of lack of funding and high risk, legislative reform is needed to facilitate investigations and prosecution to reduce risk and cost.

Of the options presented, we find Option One most appealing as we consider the current law places too much priority on debts to the Commissioner vis-à-vis other creditors which sends a poor message that the promoter penalties are aimed at Government revenue protection as opposed to serving the public interest.

EXTENDING DIRECTOR PENALTY NOTICE REGIME TO GST

QUESTIONS

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.

Pitcher Partners rates this measure with a moderate to poor prospect of effectiveness.

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

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

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

The following submission is in response to questions 56 to 58 inclusive.

As a disrupter to illegal phoenix activity, we consider the proposed reform would be relatively ineffective.

We see the following benefits and risks to extending the DPN regime to include GST:

Benefits	Risks
Imposing personal liability upon directors for the debts of the company would likely discourage phoenix activity where the company's liabilities consist of GST debts, as is now the case with PAYG and superannuation liabilities.	
With the changes removing the option of appointing a liquidator or administrator where obligations are unreported, adding GST to PAYG and superannuation would provide a further incentive to ensure company lodgements are on time and books and records are better maintained.	<p>After recent policy shifts to encourage commercial risk taking such as the safe harbour provisions, the proposed change threatens to undermine this approach by discouraging entrepreneurship.</p> <p>It will be seen as a penalty impost on the middle market to meet the deficiencies experienced by the regulators in curtailing phoenix activity. It can be likened to 'using a sledge hammer to crack a walnut'.</p>

In the middle market, the proposal will act as a deterrent to innovation and entrepreneurial behaviours, and is an unnecessary penalty imposed on business due to the operation of phoenix facilitators where activities can best be addressed through alternative proposals discussed elsewhere in this paper.

Expanding the potential personal exposure of directors to include GST undermines the broader economic benefits of entrepreneurship and clashes with the policy shift towards encouraging commercial risk taking with the safe harbour provisions. The proposal would be much more beneficial if it can be applied more surgically rather than as it currently stands, which appears to use a sledgehammer to crack a walnut.

The proposal would also lead to an increase in the ATO's priority position and this will have a significant impact on other creditors. Small business and middle market creditors will be disadvantaged by the ability of the ATO to recover debt from insolvent debtors.

SECURITY DEPOSITS

QUESTIONS

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.

Pitcher Partners rates this measure to be moderately effective.

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

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

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

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

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

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

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

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

The following submission is in response to questions 60 to 67, inclusive.

Pitcher Partners considers the proposal to strengthen the effectiveness of the security deposit power to target illegal phoenixing is that it comes at the cost of small to medium businesses that would otherwise rank as unsecured creditors in an insolvency. The results of this proposal would be to provide greater protection for the ATO and in effect, to elevate its priority. The improvements to garnishee provisions similarly would operate to provide the ATO with an unfair advantage over small to medium enterprise creditors of an insolvent company. This priority and advantage is further exacerbated by the fact that the proceeds obtained by the ATO from such garnishees are not subject to potential recovery as preferential payments in the event of a subsequent liquidation, even where such garnishees are enforced after the appointment of a voluntary administrator against both pre appointment and post appointment debtors.

In the event this provision is enacted, Pitcher Partners would propose that recoveries made by the ATO from garnishees be subject to the potential recovery provisions for preferential payments in the event of a subsequent liquidation, so that the ATO is not unfairly advantaged as against small to middle market creditors.

DEALING WITH HIGHER RISK ENTITIES – TARGETING, DESIGNATION AS HRE & HRPO

QUESTIONS

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.

Pitcher Partners rates this measure as having a moderate to high level of effectiveness.

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

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

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

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

73. Should 'associate' be defined or determined administratively?

The following submission is in response to questions 68 to 73 inclusive.

We refer you to our response to questions 20 and 21. We support the introduction of the HRE and HRPO regime, save for the cab rank appointment of liquidators. Pitcher Partners considers the proposal of targeting HREs and HRPOs, depending on the deterrents involved, as potentially highly effective.

The primary benefits are simultaneously minimising the collateral damage to directors of businesses that fail legitimately and who act appropriately whilst allowing for a 'surgical targeting' of rogue phoenix operators.

In our view, the primary risk is in its execution. However, the proposed two-step process and notification safeguards ought to provide sufficient layers of review to mitigate this risk.

CAB RANK BASIS

QUESTIONS

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.

Pitcher Partners rates this measure as being ineffective.

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

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

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

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

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

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

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

The following submission responds to questions 75 to 80 inclusive.

In principle, Pitcher Partners is in favour of restricting HRPOs from selecting a liquidator. However, a cab rank selection process would also, in our view, be the least effective alternative option given the possibility the cab rank roster system will presumably be open to all liquidators it would not of itself avoid the prospect that ill resourced or equipped liquidators may receive the appointment. The current system has, in our opinion, sufficient safeguards to prevent the facilitation of phoenix activity by appointing inappropriate external administrators including the need for liquidators to consider and lodge a Declaration of Independence and Relevant Relationships and the Insolvency Law Reforms recently introduced to facilitate the removal/replacement of a liquidator.

The rights of non-related party creditors to obtain a consent from their selected practitioner in a Court winding up process should not be impeded.

GOVERNMENT LIQUIDATOR

QUESTIONS

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.

Pitcher Partners rates this measure to be ineffective.

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

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

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

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

Our submission in response to questions 82 to 85 inclusive are listed below.

Pitcher Partners does not support the proposal to establish a government liquidator. In our view it represents an unnecessary and inappropriate response to phoenix activity. Further, registered liquidators are more likely to be better qualified, resourced, trained and experienced to administer insolvencies than a government liquidator would likely to be. Finally, the government is often a major creditor in an insolvency and would therefore face questions of conflict of interest and independence to a much larger degree than registered liquidators.

It is difficult to identify benefits over and above those already achieved by creditors including the Commissioner appointing and/or influencing the appointment of an appropriate practitioner and we accordingly consider this proposal would be ineffective.

REMOVING 21 DAY WAITING PERIOD FOR DPN

QUESTIONS

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.

Pitcher Partners rates this measure as moderately effective.

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

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

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

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

Our submission in response to questions 87 to 90 inclusive are listed below.

Pitcher Partners is of the view that the approach of removing the 21 day notice period for the company of a designated HRPO director is consistent with the principle that high risk directors are afforded minimal flexibility. We refer you to the submissions made by us in paragraphs 56 to 59 inclusive.

EMPOWERING ATO TO RETAIN REFUNDS

QUESTIONS

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.

Pitcher Partners rates this measure to be effective.

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

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

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

Our submission in response to questions 92 to 94 inclusive are listed below.

Pitcher Partners is supportive of proposals designed to target HRPOs who have failed to provide notifications/lodgements capable of affecting their tax liability. The benefits of this approach is that it is targeted to 'known offenders' and will not therefore disrupt normal business operation.

Pitcher Partners would support personal GST liability for HRPOs who have failed to notify/lodge appropriate returns and have failed to pay the GST liability.