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KordaMentha
Restructuring

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By email: Phoenixing@treasury.gov.au

Dear Nathania

Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018

This submission is made by KordaMentha. We support the positions outlined in the submission of the Australian Restructuring Insolvency and Turnaround Association ('ARITA') dated 27 September 2018.

In addition, we make the following comments in the context of KordaMentha's experience in corporate insolvencies and restructurings, most of which were conveyed to you by us in the roundtable discussion which occurred in Melbourne on 5 September 2018.

General Comments

We support the Government's commitment to combatting practices which constitute illegal phoenixing, however, as outlined in our previous submission dated 27 October 2017, we believe a variety of laws and penalties for transactions, acts and omissions which either constitute or facilitate illegal phoenix activity already exist. Rather than creating new laws, we submitted that the present laws need enforcement and harsher penalties.

Our concern with many of the reforms in the Exposure Draft is that practically Liquidators will find themselves in the same position they do now, unfunded and with inadequate books and records to bring any type of action under the proposed new laws. Without significant ASIC resources to, amongst other things, consider and act on administrative recovery notice requests and an easier process to access the Assetless Administration Fund for Liquidators, we query how often these reforms will result in recoveries for creditors and prosecution of those facilitating or involved in illegal phoenix activity.

The example of a current liquidation, shared with you in the roundtable, is a case in point. None of the draft reforms would result in recovery for creditors or prosecution of the director as we simply do not have adequate books and records for such action. As previously submitted, we believe directors should face more serious consequences for not delivering books and records of a company to a liquidator or not maintaining books and records in accordance with section 286 of the Corporations Act. The excuse of 'the books and records were destroyed in a fire/by the landlord/by opening an email containing a

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virus' are all too commonly proffered up as excuses by directors as to why they cannot provide evidence which could otherwise prove illegal phoenix activity.

Perhaps consideration should be given to making transactions voidable unless directors can prove to the court otherwise, if assets have been sold/transferred to related entities and the directors of the company cannot provide sufficient evidence documenting the transaction, the value of the transaction and provide sufficient company books and records to prove the assets/liabilities transferred. This should essentially be the information which could be produced to support/evidence a similar transaction with an independent third party.

Exposure Draft

Page 8, Section 588FG (9)

We find it very difficult to understand what 588FG (9)(b) is trying to convey. The double 'not' makes the section confusing.

Page 9, Section 588FGAA

As mentioned above, our concern with this section is that there will be insufficient ASIC resources to enable ASIC to consider order requests from Liquidators. If there is an increased cost to ASIC, it must not be borne by Registered Liquidators under ASIC's industry funding model. If the cost is to be passed on, it will undermine whatever utility there may be in these orders.

Page 29, Improving the accountability of resigning directors

Under section 205B (5) a company must notify ASIC within 28 days if a person is appointed as a director or stops being a director. The company's obligation to notify ASIC of a director's resignation may be satisfied by the resigning director notifying ASIC themselves. Under section 205A a resigning director may give ASIC written notice of their resignation.

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

We consider that the onus under section 205B (5) should be reversed, i.e. a director must notify ASIC and the director's obligation may be satisfied by the company notifying ASIC. If responsibility for notifying ASIC was to attach to the individual director who has resigned, this would provide a direct benefit to directors in that they can obtain certainty that their resignation has been acknowledged and recorded.

Whilst the proposed provisions close one loophole by preventing a director from resigning and leaving a company without a director, they do not close another problematic loophole of companies being deregistered by ASIC for non-lodgement of returns or unpaid review fees (section 601AB (1) and (1A)) without the company being subject of an investigation by a liquidator. In these circumstances, companies are deregistered without someone having to make the declarations required under the voluntary deregistration process under section 601AA including that the company has less than $1,000 of assets and no liabilities. This is a loophole that can continue to play into the hands of facilitators of phoenix activity.

Explanatory Memorandum

The concept of 'market value' is included in the exposure draft and explained in the explanatory memorandum. We have concerns that it has been assumed that 'market value' is an easy concept to prove. Case law, particularly in respect of section 420A of the Corporations Act suggests that market value is tied to a process of adequately testing the market. The market value test only looks at the consideration for the asset rather than considering the overall benefit of the transaction as say the existing uncommercial transaction provisions do.

We have concerns that legitimate third party buyers of distressed assets who may consider buying an asset at a discount on the basis of limited due diligence, a short time table, or 'as is, where is' will not be able to satisfy themselves that they will have clear title and decide they would rather wait for an insolvency event before purchasing. If that were to occur, the price paid would likely be even less.

The examples in the explanatory memorandum include references to 'the market value is…' without explaining how the market value was determined. The proposed reforms assume it is easy to determine an obvious market value for every asset/business. There are many examples of assets or businesses where this is not the case. For example, how would you determine the market value of a small call centre business without examining the benefits and detriments of the transaction? Where an asset does not have an obvious market value, section 420A of the Corporations Act has a second limb to it namely 'otherwise the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold'. We query whether something like this or the use of wording along the lines of 'valuable consideration' should be considered in these reforms.

Yours sincerely

Leanne Chesser
Partner