26 September 2018

Ms Nathania Nero
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Corporations Policy Unit
Consumer and Corporations Division
The Treasury
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By email only: Phoenixing@treasury.gov.au

Dear Madam

Submissions – Reforms to combat illegal phoenix activity (Draft Legislation)

PricewaterhouseCoopers Australia (**PwC**) appreciates the opportunity to provide feedback and comments regarding an important area of reform for the national economy and legal framework governing Australia's corporations' legislation.

We endorse the introduction of legislation prohibiting phoenix behaviour and empowering ASIC and/or Liquidators with the ability to seek compensation and claw back phoenixed assets from illegal phoenix operators.

In our opinion the proposed recovery provision (Creditor Defeating Disposition) does little however to extend Liquidators' existing recovery powers. Section 588FB of the *Corporations Act 2001* (Cth) (**the Act**) already provides an avenue for Liquidators to seek compensation for undervalue transactions including the claw back of phoenixed assets from illegal phoenix operators. Proposed Section 588FB(6B) does not extend this power. As is well documented, the existing provisions (including Section 588FB) have proven ineffective and are easily thwarted by sharp business practices from directors of insolvent entities often facilitated by unregulated pre-insolvency advisors. We have addressed these practices in the table below.

The new provisions (in particular granting ASIC additional powers and an automatic 12 month presumption of insolvency), whilst welcomed, will do little to curtail phoenix behaviour.

In our view a more appropriate legislative change would be to require that the vendor entity pursuing a sale of its assets and/or business:

1. meets the safe harbour requirements outlined in section 588GA(2) of the Act; and
2. the proceeds from the sale are paid to creditors in accordance with pari passu principles consistent with section 556 of the Act.

We further recommend that legitimate restructuring and honest business rescues should be encouraged by the legislation. This could be achieved by adopting the UK (and potentially some parts of the NZ) model. Whilst the current drafting attempts to achieve this by exempting conduct from the phoenix offence provided a market valuation was obtained, it still falls considerably short of the UK/NZ models and in our opinion is grossly inadequate and will do little to protect creditors and the public from illegal phoenix behaviour.

Overall the concerns we have with the proposed laws as well our suggested changes can be summarised as follows:

Concern	Basis	Improvement
Inadequate consideration	The proposed legislation, whilst citing market valuation as the basis for any defence, fails to deal with the distribution of the proceeds of the sale of business and/or assets. In particular it fails to prevent directors of insolvent entities deferring consideration and/or preferring certain creditors (such as related parties) to the detriment of other third parties (like the ATO).	We strongly recommend that: 1. directors consider the 'better outcome' test as required under the 'safe harbour' regime; and 2. the proceeds from the sale are paid to creditors in accordance with pari passu principles. This will ensure that the proposed sale by the vendor is proactively considering the best outcome for creditors. It further ensures that all creditors are treated equally consistent with pari passu principles.
Lack of independence	The proposed legislation allows the insolvent entity to both: 1. commission a valuation 2. enter into a transaction with a successor company without any independent oversight by a third party.	In absence of safe harbour protection, we recommend that any phoenix transaction with a successor company is entered into by an external administrator. For related party transactions further oversight (such as via the pre-pack pool as is the case in the UK) and requirements may be required. This will provide some independence to the process to ensure that the valuation obtained has not been engineered by the insolvent directors and subject to other sharp business practices.
Clandestine approach	The proposed legislation does not require any communications to creditors of the insolvent entity about the phoenix transaction.	The appointment of an external administrator following entering into the phoenix transaction will ensure creditors are informed immediately of the phoenix. In addition to the above, or in the alternative, we recommend adopting a NZ style approach, requiring the insolvent/successor companies are required to communicate to creditors informing them of the phoenix transaction.

Unreliable valuations	The proposed legislation lacks any specific requirements surrounding the valuation report required to be obtained.	We strongly recommend that the valuation must come from an appropriate valuer with requisite experience, minimum levels of professional indemnity cover and regulated by an industry or regulated body. The valuation itself cannot be a desktop or rely on unsubstantiated assumptions.
Unregulated operators	The proposed legislation allows directors of insolvent entities to directly enter into these transactions.	The proposed laws do nothing to prevent the operation of unregulated, unlicensed pre-insolvency advisors, who are key facilitators of phoenix behaviour. In absence of safe harbour protection, we strongly recommend that any phoenix transaction must be executed by a properly qualified professional such as a licensed and registered liquidator whom holds professional indemnity cover and is regulated by an industry or government body, such as ASIC. The requirements for a properly qualified expert to advise a company in a 'safe harbour' environment could be similarly used.
Insolvent zombie companies	The proposed legislation does nothing to prevent insolvent trading after the phoenix transaction has been executed. Furthermore given the lack of assets in the insolvent it is quite possible that it will result in a growing number of insolvent zombie companies with no assets to fund their winding up.	By requiring an external administrator to execute the transaction this provides a mechanism for insolvent entities to be wound up and properly funded from the proceeds of the asset realisation.
Not an active deterrent	We do not consider the proposed legislation will act as a deterrent to share business practices. Directors of insolvent entities and pre-insolvency advisors are most commonly the perpetrators of sharp business practices. We do not consider the proposed requirements of a market valuation as a sufficient hurdle for them to engineer an outcome that suits their interests, much to the detriment of third party creditors.	

We would welcome the opportunity to discuss the contents contained herein at your earliest convenience.

About PwC

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PwC Australia is a partnership comprised of 700 partners Australia wide. Having grown from a one-man Melbourne accountancy practice in 1874 to the worldwide merger of Price Waterhouse and Coopers & Lybrand in 1998, PwC Australia now employs more than 7,000 people.

PwC Australia is a Partnership which provides a range of services to 96 per cent of the ASX 200 and 98 per cent of the ASX 100 and public entities at the Federal, State and Local levels. We are one of Australia's leading professional services providers generating in excess of $2.35 billion in annual revenue in FY18 and employing over 7,000 full time employees.

Yours faithfully

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