Phoenixing: A concept best left in the *Harry Potter* books

Recent changes in restructuring laws in Australia, such as the introduction of the 'safe harbour' provisions, aim to motivate directors to embrace change and restructuring efforts to save distressed companies. However, further proposed and possible reforms on the horizon focus on stemming directors' involvement in "unsavoury" restructuring, namely that of Phoenixing.

The Proposed Phoenixing Law Changes

The practice of Phoenixing, whereby the assets of a financially distressed company are transferred to another associated entity leaving creditors of the distressed company with little chance of recovery, is estimated to cost the Australian economy between $2.9 billion to $5.1 billion annually.

On 4 July 2019, the *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019* (Cth) (**Phoenixing Bill**) was reintroduced to the House of Representatives. The Phoenixing Bill proposes a new voidable transaction referred to as a 'creditor-defeating disposition' to tackle the Phoenixing problem.

A disposition will be a 'creditor-defeating disposition' where the two following criteria are satisfied:

(a) the consideration payable for the disposition is less than the lesser of either:

  (i) the market value of the property; or

  (ii) the best price that can be reasonably obtained for the property; and

(b) the disposition has the effect of:

  (i) preventing the property from becoming available for the benefit of creditors in a winding up; or

  (ii) hindering, or significantly delaying, the process of making the property available for the benefit of creditors.

Where a 'creditor-defeating disposition' has occurred, it will then be a voidable transaction where:

(a) the transaction was entered into when the company was insolvent, during the 12 months ending on the relation-back day or after that day and before the winding up began;

(b) the company became insolvent as a result of the transaction during the 12 months ending on the relation-back day or after that day and before the winding up began; or

(c) less than 12 months after the transaction, the company is placed into external administration as a direct or indirect result of the transaction.

The Phoenixing Bill also includes a new power for the Australian Securities and Investments Commission (**ASIC**) to issue an order, on a request by a liquidator, that a person receiving property under a voidable 'creditor-defeating disposition' either return the property or its value to the company. This new power is significant, as it would allow a liquidator to circumvent the need to commence court proceedings in respect of the voidable disposition and places the onus on the person subject to the order bringing an application to have it set aside.

Another feature of the Phoenixing Bill is that it introduces duties on officers of companies to refrain from causing a company to enter into creditor-defeating dispositions. Officers also have a duty to refrain from procuring such dispositions. A failure to comply with either of these duties may result in significant criminal or civil penalties.

Are the current laws not enough?

The *Corporations Act 2001* (Cth) already contains provisions relating to uncommercial transactions and, in particular, uncommercial transactions with a creditor defeating purpose. There has been some activity in this area by ASIC where people have been imprisoned and/or required to repay monies obtained through Phoenixing activity, however, such activity has not halted the practice.

Under the Phoenixing Bill, a disposition of a company's property will automatically be considered a 'creditor-defeating disposition' and consideration is not required as to whether there was a prerequisite intention to defeat creditors. Moreover, where the company has failed to keep financial records relating to the disposition, the disposition is presumed to be made for less than both market value and best price reasonably obtainable for the property. The proposed laws therefore offer an alternative, and arguably easier to prove, avenue to the current actions available under the *Corporations Act*. It seems likely that, if introduced, the new 'creditor-defeating disposition' voidable transaction may be run in the alternative to an uncommercial transaction.

In addition, and possibly of more significance, the ability of ASIC to issue an order, which in effect reverses the onus of proof to the person subject to the order is another manner in which the proposed laws offer greater ease of enforcement against Phoenixing activity.

What else can help?

Funding to Liquidators

While the current laws allow for imprisonment and/or reparation orders to be made, the view amongst the profession is that the current laws make it challenging to obtain such orders. It is hoped that if the Phoenixing Bill becomes law that this will change. Having said that, there is a feeling amongst the profession that what is also needed is funding for liquidators who will see potential Phoenixing activity but are unable to investigate because they lack funds. It seems to us that there needs to be an attack on all levels, particularly around pre-insolvency advisors who are not registered liquidators, not bound by Codes of Conduct and who advise clients to be involved in Phoenixing activity. We acknowledge that not all pre-insolvency advisors are involved in such activities, however, because of a lack of regulation of such

advisors, unscrupulous operators are creating issues and headaches for liquidators and regulators alike.

With a combination of the Phoenixing Bill and more funding being available for liquidators, there is hope that such pre-insolvency advisors can be investigated and brought to account with a possible knock on effect within this space.

Director Identification Numbers

The *Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2019* (Cth) (**Registries Bill**) lapsed on 11 April 2019, as a result of the Federal Election. It is hoped that the Registries Bill, at least insofar as it proposed the introduction of director identification numbers (**DINs**), will come back before the Australian Parliament as a further measure to assist with the crack down on Phoenixing practices.

Under the lapsed DIN changes, every director of an Australian registered entity will have an individually allocated DIN. The DIN will remain allocated to that person even after they cease being a director or when they take on new directorship roles. The purpose of the DIN is to improve traceability of directors across entities and, through a identity verification mechanism in the DIN application process, will also prevent unscrupulous directors using fictitious names or other techniques to avoid prosecution for *inter alia* Phoenixing practices.

The introduction of DINs could also have the benefit of removing personal information of directors which is currently publicly listed on company searches.

Conclusion

Clearly, there is still work to be done in this area. It is hoped that the Phoenixing Bill is passed and the Registries Bill is reintroduced and ultimately passed. Having said that, the passing of these Bills only forms part of the puzzle around pre-insolvency advisors, unscrupulous directors and Phoenixing activity. There needs to be financial assistance to liquidators to allow funding for investigations into such activity. If all could come together, we could see a very different landscape for creditors and the economy alike.

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