

## **EXISTING MECHANISMS TO ADDRESS FRAUDULENT PHOENIX ACTIVITY IN AUSTRALIA'S CORPORATE LAW REGIME**

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Australia's corporate law regime is based on the separation of ownership and control with the *Corporations Act 2001* (Corporations Act) imposing certain duties on directors to ensure their loyalty to the company. These statutory duties are in addition to those duties which directors have under the general law as fiduciaries.

If a director is involved in phoenix activity, they may be in breach of a number of directors' duties, in particular the duty of good faith, duties concerning proper use of information or position and the duty not to allow a company to continue to incur debts where the company is insolvent. Fraudulent phoenix activity may also involve voidable transactions or contraventions of the provisions of Part 5.8A of the Corporations Act aimed at protecting employee entitlements. In these circumstances civil recovery mechanisms, and other general features of the law that seek to protect creditors and company members against unscrupulous operators may be initiated by creditors.

### **SANCTIONING DIRECTOR MISCONDUCT**

The Corporations Act does not define phoenix activity as such, but provides sanctions where a director has contravened certain provisions. The Act provides for the disqualification of directors from managing corporations where they have been involved in multiple corporate failures. To ensure adequate coverage of the provisions, the law takes a broad functional approach to what constitutes 'management'. It includes communicating instructions or wishes to the directors of a corporation intending those directors to act in accordance with those instructions or wishes, or knowing that such directors are accustomed to do so.

Under the disqualification provisions, the Australian Securities and Investments Commission (ASIC) is able to have a person disqualified as a director for up to five years without the need for court action, where that person has been a director of two or more corporations that have been wound up within a seven year period, and a liquidator has reported that the corporations are unable to pay more than 50 cents in the dollar to unsecured creditors. ASIC may apply to a court to have a 5 year disqualification order extended by up to 15 years (ie to 20 years). In addition, a court may disqualify a person for 20 years, if the court is satisfied both that the person was responsible for the failure of two or more corporations, and that the disqualification is justified.

If a person manages a corporation whilst disqualified, they commit an offence and may incur a fine or a term of imprisonment.

A breach of directors duties may also result in other sanctions including significant civil and criminal penalties, compensation orders, and (in some cases) imprisonment.

## **ADMINISTRATIVE PROGRAMS AND LAW ENFORCEMENT**

There are a number of ASIC administrative programs in place to deter fraudulent phoenix company activity. They include the Assetless Administration fund, the National Insolvent Trading Program, the Liquidator Assistance Program and company surveillance programs undertaken by ASIC. These programs can lead to the banning of directors or, in some cases, more serious action, such as fines or prosecutions. The kind of breaches that these programs seek to target include fraudulent phoenix company activities, breaches of directors' and officers' duties, continuing to take part in the management of a company whilst disqualified, failure by a director to take reasonable steps to ensure that the company maintains adequate books and records, insolvent trading, fraud, misrepresentation and theft of property.

### **THE ASSETLESS ADMINISTRATION FUND**

The Assetless Administration Fund finances preliminary investigations by expert liquidators of companies, selected by ASIC, that have been left insolvent with little or no assets. Since the AA Fund was launched on 22 February 2006 to 30 September 2008, ASIC approved 385 applications for funding of reports on potential director banning matters. An average of \$5,227 has been committed to each approved application. As at 4 October 2007 liquidator reports funded by the AA Fund have led to 68 directors being banned.

ASIC has also approved many applications for funding for reports on potential breaches of the Act. The average amount of funding committed to an approved application is approximately \$41,000. Potential breaches involved in these applications include:

- breaches of directors' and officers' duties (s180-184);
- continuing to take part in the management of a company whilst disqualified (s206A);
- failure by a director to take reasonable steps to ensure that the company maintains adequate books & records (s344);
- unauthorised use of an officer's powers following the winding up of the company (s471A);
- insolvent trading (s588G);
- fraud, misrepresentation or theft of property (s590);
- application of money to be held on trust (s722); and
- lodging a false or misleading document (s1308).

### **ASIC'S NATIONAL INSOLVENT TRADING PROGRAM**

ASIC's National Insolvent Trading Program is in its fourth year. It aims to have company directors actively manage their company's financial position and act early or seek early advice when financial difficulties arise. The program reduces the risk of insolvent trading, with its potentially serious impact on creditors and the business

community, and assists directors of companies in financial difficulties to improve the company's overall performance.

In 2007/2008 ASIC conducted surveillance visits of 240 companies (including a number of related companies). Twenty-eight companies had an external administrator appointed following a visit.

Outcomes ranging from companies seeking professional advice or obtaining an accurate financial position, through to restructuring, refinancing or raising further capital, have been achieved through this Program.

#### **ASIC'S LIQUIDATOR ASSISTANCE PROGRAM**

ASIC's liquidator assistance program aims to ensure directors of companies in external administration comply with their obligations to provide information about companies they managed, for example about the location of company records and assets and the provision of information relating to the company's finances and history. Directors who fail in these obligations immediately find themselves the subject of ASIC initiated court action. This program facilitates the timely and efficient process of receivership, administration or winding up of companies under external administration.

In 2007/2008, 574 company officers were prosecuted in relation to 1067 external administration assistance offences. Fines and costs of approximately \$980,000 were ordered from these prosecutions.

ASIC has the ability to seek injunctive relief to prevent company assets being dissipated. It can also utilise its power to seek the reinstatement of companies that have been deregistered.