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Nathania Nero
Senior Adviser
Corporations Policy Unit
Consumer and Corporations Division
The Treasury
Level 5, 100 Market Street
SYDNEY 2000

Email: Phoenixing@treasury.gov.au

Dear Nathania

Reforms to combat illegal phoenix activity – Draft Legislation

Governance Institute of Australia (Governance Institute) is the only independent professional association with a sole focus on whole-of-organisation governance. Our education, support and networking opportunities for directors, company secretaries, governance professionals and risk managers are unrivalled.

Our members have primary responsibility for developing and implementing governance and risk management frameworks in public listed, unlisted and private companies. They are frequently those with primary responsibility for the administration of company records, dealing and communicating with ASIC and interacting with business registries. Our members have a thorough working knowledge of the *Corporations Act 2001* (the Corporations Act). We have drawn on their experience in our submission.

Governance Institute is a member of the ASIC Business Advisory Committee and Treasury's Director Identification Number Reference Group.

Governance Institute participated in Treasury's phoenix roundtable on 3 September 2018 and welcomes the opportunity to comment on the exposure draft legislation for the package of reforms to combat illegal phoenix activity.

Governance Institute supports the objectives of the illegal phoenix activity reforms and commends the Government's commitment to addressing the deficiencies in the current laws exploited by some company directors to obscure their role in company decisions, shift accountability to other directors and facilitate phoenixing activity. We consider that the proposed introduction by the Government of a Director Identification Number (DIN) is an important part of the reforms to combat illegal phoenix behaviour as it will enable regulators, creditors and liquidators to trace the relationship of directors across companies and confirm their identity.

Governance Institute has long advocated for the introduction of a DIN in order to address information confidentiality and security concerns of directors and company secretaries concerning publication of personal data. The advantages that a DIN provides for an officeholder's privacy and security intersects neatly with the advantages of using the DIN to deter and penalise illegal phoenix activity.

We support the extension of the DIN regime to company secretaries and consider that the DIN will protect honest officeholders from the risk of identity theft and assaults on personal security. Our recommendations concerning the introduction of the DIN are contained in our submission to Treasury on the Modernising Business Registers Program dated 12 September 2018. Please let us know if you would like us to send you a copy of that submission.

Our members have drawn to our attention some issues in the exposure draft which could give rise to some unintended consequences. We make the following recommendations which we hope will assist Treasury in the efficient implementation of the reforms.

Improving the accountability of resigning directors – preventing inappropriate backdating

Illegal phoenix operators exploit the current law by ensuring that the company (electronically or via paper copy, through an agent or directly) lodges the appropriate ASIC form noting a change of director, but the notice backdates the director's resignation so that the director cannot be held liable for offences committed after that time. In these cases, the phoenix operator seeks to shift accountability to a 'straw' director who may have no real involvement in the company or may be deceased or a fictitious person. The stated aim of the reform is to prevent directors backdating resignations to avoid liability for offending conduct, such as insolvent trading or transferring company assets to a phoenix company. We note that under the proposed law, if the resignation of a director is reported to ASIC more than 28 days after the purported resignation, the resignation takes effect from the day it is reported to ASIC.

We consider that the introduction of a DIN will go a long way towards solving the issue of 'straw' directors. In order to hold a position as a company director, a person will need to undertake an identity verification check. This should eliminate the appointment of dead or fictitious persons except in the most egregious cases of identity fraud. It will also emphasise to those applying for a directorship, the serious obligations of the role they are assuming.

We support provisions which counter the efforts of directors seeking to undertake phoenix activity. However, as currently drafted, all late lodgements of a director's resignation will be caught by the proposed changes to the Corporations Act.

Governance Institute does not condone breaches of the Corporations Act. The requirement to notify appointments and resignations of directors in a timely manner is underlined by the penalty provisions attaching to the section. However, we are aware of the realities of administering company records and understand that mistakes occur which lead to failures to notify appointments and resignations within the 28 day time period.

The proposed amendments to the Corporations Act will have the effect that notices of resignation of directors that are lodged outside the 28 day statutory period, due to an administrative or human error and with no intention of facilitating phoenixing activity, will be captured by the new provisions. This may give rise to unintended consequences.

Example one

Consider the case of a sale of a company with a settlement date of 30 June. The parties have chosen the 30 June settlement date for many reasons, such as taxation, accounting and payroll. After settlement, control of the company transfers to the new owners. The outgoing company secretary or solicitor would be responsible for undertaking certain administrative tasks arising from the transfer, including notification of resignation of the outgoing directors, effective as at 30 June.

If for some, unforeseen circumstance (such as human error, illness etc), the notification of resignation is lodged more than 28 days after the effective date, (say on 1 August) under the current law, the late lodgement will attract a late fee and the effective date of the outgoing

director's resignation will then be recorded in the ASIC register as 30 June, which reflects the reality of the transaction.

Under the new provisions, the late lodgement will result in the effective date of the outgoing directors' resignations being recorded as 1 August. This does not accurately reflect the reality of the transaction or who controls the company and will result in the outgoing directors being liable for the acts of the company's new directors until their effective resignation date. While we understand that this is the intention of the amendment, if the outgoing company directors are not involved in illegal phoenix activity, changing the date of their resignation will be for no purpose.

Example two

Another issue which our members encounter, is when they are called in to 'tidy up' a company which has been the subject of poor record keeping and resignations and appointments have not been notified to ASIC. In these cases, appointments and resignations are notified to ASIC consistent with company records such as board minutes, letters of appointment and resignation etc. Under the proposed provisions, the ASIC register will be inconsistent with the company records and will not reflect reality.

Thus, human errors which have no malicious intent, will result in considerable administrative and legal consequences.

We acknowledge that there is provision for application to be made to ASIC or the court to backdate a resignation lodged after the 28 day period, but consider that this to be a very time consuming and expensive option and query whether this is the best use of the time and resources of the courts and the regulator. We note from Treasury's June 2018 Modernising Business Registers Program paper that there are currently 2.5 million registered companies on the ASIC register and that the register processes over 2.9 million updates per year. The court system and ASIC will become overwhelmed if only a small percentage of these updates result in an application to ASIC or the courts for a backdating of a resignation.

Governance Institute recommends that rather than apply backdating prevention provisions which capture all late notifications of director's resignation, the amendments be tailored so that they only apply to situations which the Government is seeking to cover ie directors who backdate their resignations to avoid liability for insolvent trading or to facilitate phoenixing activity.

If a company goes into administration and there is evidence of phoenixing activity having taken place, a liquidator should be able to look back and investigate if a previous director has lodged a resignation that has been backdated. The liquidator should have the power to apply to set aside the date of resignation and pursue the relevant director who has backdated their resignation. The relevant period could be the relation back period for preference payments. We consider that a more targeted approach to the issue will reduce the unintended consequences which would otherwise occur.

Preventing the abandonment of companies

Governance Institute supports the abandonment prevention provisions in the exposure draft.

Governance Institute recommends that the Government consider a carve-out for unusual circumstances when a fellow director becomes disqualified by becoming bankrupt, of unsound mind or dies.

Related creditor voting rights

Governance Institute supports the amendments limiting related creditors' voting rights to the value of the consideration paid for an assigned debt, rather than its original value, when

conducting a poll for a resolution concerning the appointment or removal of an external administrator. We also consider that all such resolutions should be decided by a poll. This ensures that all those affected have the ability to be represented and their vote recognised.

Governance Institute welcomes further contact during the consultation process and the opportunity to be involved in further deliberations.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Meegan George', with a long horizontal flourish extending to the right.

Meegan George
Acting Chief Executive