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Business

## **What's in a name? Draft laws' wrong perspective on phoenix companies**

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Comment

ON DECEMBER 20 the Gillard government quietly opened for public consultation a set of draft laws designed to crack down on phoenix companies — those that collapse one day with a pile of debts and, like the bird in Greek mythology, rise from the ashes and open with the same assets and customers. The nefarious practice enables them to avoid taxes, wages and other bills.

It costs the economy billions of dollars a year, and despite myriad reforms in the past few years, phoenix activity remains strong. According to the Australian Taxation Office, there are about 6000 phoenix companies in Australia and from 7500 to 9000 directors who will have personal liabilities under this legislation.

While the draft legislation is the federal government's latest attempt to curb the illegal practice of "phoenixing", it is too narrow in its definition — assuming a phoenix company re-emerges using the same name or a similar name — and runs the risk of strangling the corporate sector with more red tape. It also ignores the real problem, which is that the current system of debt collecting is too expensive and risky.

Phoenix activity was first exposed in 2001 during the Cole royal commission on corruption in the building and construction industry, which uncovered at least 18 cases of it. Since then it has been identified in several other industries, most notably property, information technology, telemarketing and other labour-intensive industries.

The latest round of reforms includes the introduction of a Similar Names Bill, which imposes personal liability on directors for the debts of a company that has a similar name to a pre-liquidation name of a failed company — otherwise known as a phoenix company. The debts include staff entitlements, tax and money owed to unsecured creditors.

The draft legislation states that directors will be personally liable for the debts of the phoenix company: if they were on the board during the 12 months before the failed company was wound up; if the new company has a name that is similar to, or the same as, that of the failed company; if the debt was incurred within five years of the start of the winding up of the failed company; and if the debt is incurred after the legislation comes into force.

What this means is that if the new company has a name similar to the old company's then the director of the new company is personally liable for all debts of the new company for five years. Not surprisingly, this has put fear into the hearts of company directors, who are worried they may become personally liable for something they were not aware was going on.

But as for cracking down on phoenix activity, it will have limited impact because it is aimed at businesses that start again with names similar to the original. Most phoenix companies use different names because the old name is tainted.

In the case of the Phoenixing and Other Measures Bill 2012, amendments to the Corporations Act give the Australian Securities and Investments Commission additional powers to wind up a company that appears to no longer be carrying on its business. This will hopefully encourage ASIC to take a harder line on companies that continually fail to lodge their accounts.

The government did itself few favours by releasing the two draft bills five days before Christmas and giving the public short deadlines of January 24 to comment on the Phoenixing Bill and February 29 to comment on the Similar Names Bill. The timing is made worse by the fact that businesses have been asked to put in submissions for so many other inquiries and draft legislation.

This is the second attempt to crack down on phoenix companies in two years. In 2010 the government beefed up the Tax Office's powers to enable it to demand "security deposits" for existing and future tax debts if it suspects the business may be at risk of becoming a phoenix.

**Prushka's** Roger Mendelson, who comes across phoenix companies as part of his

debt-collecting business, says last year's reforms were "useless in that all they did was to give priority to the ATO. They did nothing for other creditors".

The best way to reduce phoenix activity, according to Mendelson, is to compel companies to provide a "solvency statement" to any intending or current creditor on request. If the statement turns out to be incorrect, the way would be open for a creditor to sue the company's directors, who would become personally liable.

At present, it is all too hard — and expensive. In the past year there has been a noticeable increase in debtor companies either unwilling or unable to pay debts, even after the company has been sued and a judgment made against it. After judgment, the normal process is to serve a statutory demand on the company; if it still doesn't pay up — usually within 21 days — it is deemed to be insolvent and the creditor can proceed with a petition to wind it up.

But according to Mendelson, even when statutory demands are issued, creditors are prepared to proceed to wind up only in about 10 per cent of cases because the chances of recovery are so low that it would be a bad commercial risk to proceed.

As long as this is allowed to continue, phoenixing will continue to thrive.

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