Submission to the Minister for Revenue and Financial Services in relation to anti-phoenixing legislative proposals.

DETAILS OF PARTIES MAKING THE SUBMISSION

1) This submission is made on behalf of Mendelsons National Debt Collection Lawyers Pty Ltd ACN 125 099 701 ('Mendelsons') and Prushka Fast Debt Recovery Pty Ltd ACN 005 962 854 ('Prushka').

2) Mendelsons is the in house law firm of Prushka and it focusses on debt recovery and insolvency in all Australian jurisdictions.

3) Prushka has a 41 year history and handles debt collection work for over 55,000 businesses across Australia, mostly being SMEs but also for larger corporate clients. Prushka acts on the No Recovery – No Charge basis and has a strong presence across regional Australia.

4) This submission is written by Roger Mendelson, who is Principal Lawyer of Mendelsons and is CEO of Prushka.

COMMENT ON PHOENIXING ACTIVITY

5) Due to the large number of debt claims handled by Prushka, it has exposure to phoenixing activity at close quarters. Due to the large client base, it is common for more than one client to have outstanding debts owed by one corporate debtor.

6) As a general observation, we believe that fraudulent phoenixing activity, although significant in terms of tax revenue loss, is not significant in terms of corporate debts being unpaid.

7) Fraudulent phoenixing is very much focused on retaining funds otherwise due to the ATO, such as individual tax retention and GST and normally relates to failure to fully remit amounts due under the BAS system.

8) Such activity is clearly illegal and criminal and there are probably sufficient measures in place to counter such activity, although what has been lacking is the allocation of resources to do so.

PROPOSALS

9) We support the idea of Director Identification Number (DIN) because it will certainly make it easier to track directors and will act as a means of deterrent for directors who are serially

operating companies which will ultimately fail. The impact will be similar to the introduction of the ACN, which made it much easier to track companies.

10) However, most of the recommended provisions are aimed at protecting tax revenue, rather than the rights of other creditors.

11) The ATO has significant priority rights as opposed to other creditors, through processes such as the Director Penalty Notice, which in many cases allows the ATO to make claims directly on directors of failed companies for unpaid tax liability.

12) Processes to protect the tax revenue are in most cases detrimental to other creditors because priority payments to the ATO result in less available funds for other creditors.

PROBLEMS FACED BY SMEs

13) By far the greater problem faced by SMEs is in dealing with debtor companies which are essentially under-capitalized and which in many cases are simply doomed to fail, due to lack of business experience and, in many cases, a business model which is unlikely to be successful. These companies survive for a period of time by the directors taking out funds on which to live and by then juggling creditors and BAS obligations. In most cases, there is no fraudulent intent but more an unrealistic expectation that the company will continue to trade and be able to pay its obligations.

14) A common situation is where the company then faces legal pressure from creditors and also finds it harder to obtain credit, so the directors simply jettison it and commence in a fresh company, where the pattern tends to be repeated. This process can be carried out because it is extremely difficult for creditors to take successful legal action to get their hands on the assets of the directors.

15) This is a far greater problem for SMEs than illegal, criminal, fraudulent phoenixing activity.

WHAT CAN SMEs DO?

16) The standard advice for potential creditors of small companies is to do credit checks, talk to trade references, do a company search to see if there has been any wind-up activity and also ask for personal guarantees from the directors.

17) Nothing in the proposed anti-phoenixing proposals would alter the advice to creditors to carry out such checks and obtain guarantees.

18) The proposals we set out below are more far-reaching but would significantly reduce the risks creditors take in advancing credit to small companies and would act as a brake on operators who have a pattern of setting up companies which ultimately fail.

REGISTER OF STATUTORY DEMANDS

19) Under the Corporations Law (Section 459E), it is possible to serve a Statutory Demand on a company where the debt owed exceeds $2,000.00 and where it is not subject to dispute. No judgment is required.

20) Mendelsons use the Statutory Demand process on a regular basis and obtain good results from it.

21) The benefits are that there are no external disbursements payable and it is quick and cheap.

22) The way the process works is that the Statutory Demand is served on the company by post at its registered address and it details the amount demanded. The debtor-company has 21 days in which to "satisfy the Demand" or otherwise, to take action in the court to seek an order that there is a genuine dispute about the account or that otherwise, the company is solvent.

23) In our experience, it is rare for a company to respond to the Statutory Demand by seeking a court order and the greatest response is usually to pay or settle the amount demanded.

24) If the Statutory Demand is not satisfied and no action is taken by the debtor-company, then from that time onward, the debtor-company is deemed to be insolvent and if it continues trading, the directors are personally exposed to insolvent trading action in relation to any losses suffered by creditors after that date. From that time, the creditor may then use the failure to satisfy the Statutory Demand as a ground for commencing wind-up action of the company.

25) The problem is that many companies simply do not respond to a Statutory Demand and continue trading, in the knowledge that the creditor is unlikely to incur the cost of wind-up action (approximately $5,000.00), on the basis that it is unlikely to provide a financial return.

STATUTORY DEMAND REGISTER ('REGISTER')

26) Our first proposal is that a register be set up by ASIC of companies which have been subject to a Statutory Demand which has not been satisfied, where the debtor company has not initiated legal action in relation to the Statutory Demand and where the creditor has a reasonable belief that the amount demanded is still owed.

27) This is not the place to go into the proposed detailed workings of the Register but we believe that it could be set up simply, through an online process and it could be easily searched, without charge by businesses which plan to allow credit to the company. There could be a simple objection process, to ensure that the system is not abused.

28) If the Register is in place, it would be the first time there would be visibility by both the public and the regulators to Statutory Demands which are being served and which are not satisfied.

29) If this in place, recalcitrant companies which have not satisfied Statutory Demands would find it difficult to obtain credit.

SOLVENCY STATEMENTS

30) Our second proposal is that directors of a company should be obliged to sign a "Solvency Statement", if requested to by a business which intends providing credit of over a fixed sum of say $5,000.00 to that company.

31) The Solvency Statement would be signed by all directors and would state that, as at the time of the Statement, the directors are of the reasonable belief that the company is solvent (defined as being able to pay its debts as and when they fall due).

32) If the company ultimately fails to pay a genuine debt for over $5,000.00 and the creditor has received the Solvency Statement, the creditor would then be entitled to sue the directors for the amount of the debt and the sole defence of the directors would be that as at the time of the statement, the company was solvent but that a later event occurred which rendered the company unable to pay its just debts.

COMBINING STATUTORY DEMAND REGISTER WITH SOLVENCY STATEMENTS

33) An extension of the ideas expressed above would be to provide that any company which appears on the Statutory Demand Register should also be required to complete a Solvency Statement within a 14 day period, in order that it be allowed to continue trading. If it fails to provide the Solvency Statement then ASIC should have the ability to investigate the company to determine whether or not it is engaging in any of the "designated phoenixing activities" (as proposed) or to otherwise appoint an external administrator.

34) Failure to lodge a Solvency Statement in the circumstances described in paragraph 33 could also lead to deregistration of the company by ASIC.

IMPROVEMENT IN DEREGISTRATION OUTCOMES

35) Deregistration of a company can be made either by ASIC (usually for failure to lodge annual returns and pay fees) or by the directors themselves.

36) Voluntary deregistration is initiated by the directors and it involves them in signing a Statutory Declaration declaring, inter alia, that the company has no creditors when submitting the request to ASIC for it to be deregistered.

37) We come across numerous circumstances where we know that the declaration made by the directors is false, usually because we are actually dealing with the company at that time in relation to an outstanding debt.

38) In our experience, ASIC does nothing about these false declarations, which leaves creditors with no further action to take.

39) Our suggestion is that ASIC encourage creditors to lodge a complaint when a company has been deregistered by the directors and there is clearly at least one debt outstanding. The action taken should be to prosecute the directors for perjury, in that the claim would be that they have knowingly sworn a declaration which they must have known to be false.

40) Following that process would significantly reduce the number of voluntary deregistrations, which is basically regarded by shady directors as an easy and cheap way to "get rid of the company". Liquidation is expensive and a liquidator is bound to investigate past transactions which potentially would give rise to claims made against directors and shareholders.

DEREGISTRATION BY ASIC

41) A large number of companies are deregistered by ASIC each year, usually due to the failure to lodge annual returns or to pay annual fees.

42) Upon deregistration of a company, all of its assets are supposed to vest with ASIC. However, this is, to our knowledge, never undertaken. Assets include loans made by the company to associated parties, including directors and shareholders and technically these "assets" should pass to ASIC and should then be enforced as debts owing to the company, but they never are.

43) If a creditor believes that there may be assets which have simply been "spirited" away from the deregistered company, the only option is to make application to the court to reinstate the company, naming ASIC as a party and then appointing a liquidator of the company, in order that he may then review all concerning transactions undertaken by the company and undertake recovery. This is rarely done because of the high cost and risk.

44) The current process for deregistration by ASIC is simply aiding both fraudulent phoenix operators and otherwise dodgy company directors and basically acts as a barrier against recovery of debts by SMEs.

IMPROVED ACCESS TO COMPANY INFORMATION

45) We recommend that ASIC adopt the New Zealand process, whereby it is simple and cheap and immediate to search company information and to come to a relatively informed decision about the credit worthiness of the company, before advancing credit.

46) The link to this is www.companiesoffice.govt.nz

SUMMARY

47) We believe that implementation of our suggestions would very significantly reduce the risk creditors' face in providing credit to small companies and would also act as a real deterrent to entrepreneurs setting up businesses which ultimately have a low rate of success.

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