

# Sherry's insolvency law changes seem draconian



ADELE FERGUSON

**W**hat the Rudd Government gives with one hand, it takes away with the other. Or so it appears when it comes to company directors, entrepreneurship, insolvencies and the law.

Last week, the Minister for Corporate Law, Chris Bowen, released a set of proposals to reform insolvency law to give company directors more protection from distressed companies and enhance the chances of company survival.

Four days before that, Bowen's predecessor, Nick Sherry, who is now Assistant Treasurer, quietly closed submissions to a proposals paper on fraudulent phoenix activity. If the proposals become law it would tighten directors' duties and increase insolvencies in smaller companies.

Bowen's set of proposals got huge publicity, while Sherry's aggressive

set of proposals managed to avoid the glare of publicity because they were released just before Christmas. Sherry's aim is to tighten laws and directors' duties to stamp out the escalating number of phoenix companies, which he estimates costs the Tax Office more than \$650 million a year in lost revenue.

Phoenix companies refer to the practice of closing a company one day and, like the bird in Greek mythology, rising from the ashes and opening another company with the same assets and similar name to avoid paying taxes, wages and other bills with the sole purpose of cheating creditors out of their money.

While everybody agrees that phoenix companies cost the Tax Office a fortune in lost revenue, and other unsecured creditors such as suppliers an even bigger fortune, the proposals are so draconian that they could stifle entrepreneurship, lead to more insolvencies, and increase the amount of red tape that is already suffocating business.

The proposed changes include expanding the Australian Securities and Investments Commission's powers to disqualify directors, expanding the powers of the Tax Office to hold a pre-emptive bond

from companies heading into insolvency, expanding the penalty regime for directors, and restricting new companies adopting the names of liquidated companies.

It also proposes the adoption of a doctrine of "inadequate capitalisation" to lift the corporate veil where a company sets up a subsidiary with insufficient capital to meet the debts that could have reasonably been

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expected to arise. James Hardie is a case in point. However, such a measure would reduce the number of start-up businesses, and potential entrepreneurship, through increased costs caused by the need to do due diligence on the capitalisation of subsidiary companies.

In the case of the pre-emptive bond, Sherry proposes that the Tax Office is given the power to require a bond, not only in relation to income tax, but also in relation to other liab-

ilities that are often avoided through phoenix activity. It does not stipulate what those "other" liabilities are, but says if the company fails to provide the bond, an option could be imprisonment for one year.

It also proposes that the company would be required to pay a bond from its own capital or through using a third-party bond provider. If the bond could not be provided, this would reflect the inadequate resourcing of the company or the fact that its credit worthiness was such that it was unable to provide a bond using a third party. So how big should the bond be? "The amount of the bond could be limited to the liabilities that the company is expected to accrue over a certain period (say, three months), having regard to things such as size of the business, the nature of the business and the number of employees of the business."

This smacks of a half-baked proposals paper from Treasury without any supporting notes on how they arrived at such options. It also sounds like policy on the run. If anything, it is a salutary reminder that with so many inquiries going on, some legislation might get through without proper thought given to the impact on business or how it will be

administered. Sherry's controversial proposals were announced in November with little fanfare, with submissions closing on January 15, one of the worst times to expect feedback, and made worse by the fact that business has been asked to put in submissions for so many inquiries.

The few submissions Business Day has managed to locate are highly critical. The Australian Institute of Company Directors suggested testing the existing law before adding to it. "This is not a prudent way for policy frameworks or for legislation to be generated."

Roger Mendelson, of Prushka Fast Debt Recovery agency, criticises Sherry's discussion paper as being too narrow and only focusing on fraudulent activity relating to the Tax Office. Mendelson says it should include the broader perspective of individuals and companies who lose money as a result of companies which owe them money being unable to pay them. He says a number of large companies continue to trade despite having incurred debts they have no intention of paying.

The reality is that ASIC already has the powers to clamp down on illegal phoenix activity, but it doesn't use them properly.