

Phoenix activity

Sizing the problem and matching solutions

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Fair Work Ombudsman

June 2012

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Executive summary

This report presents the analysis and recommendations resulting from a project investigating phoenix activity undertaken by PwC for the Fair Work Ombudsman (FWO). The project involved three stages of analysis:

- Defining phoenix activity: a key challenge in understanding mitigating phoenix activity is accurately defining it.
- Quantifying phoenix activity: to ensure that the options for addressing phoenix activity are proportional to the scale of the problem, the impact of phoenix activity was quantified.
- Identifying possible actions to address phoenix activity: based on the identified scale of the phoenix activity and consultations with stakeholders, a range of actions have been suggested for addressing phoenix activity.

What is phoenix activity?

Phoenix activity is “the evasion of tax and other liabilities, such as employee entitlements, through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities”.² In some instances of phoenix activity only one entity within a group of companies will be liquidated, whereas in other cases the corporate group covering the whole business will be stripped of assets and liquidated. Due to the diversity of phoenix activity, it is difficult to precisely define.

Consultations with stakeholders identified a range of alternative and complementary approaches to defining phoenix activity. Based on a range of considerations, the following definition has been developed:

“Phoenix activity is the deliberate and systematic liquidation of a corporate trading entity which occurs with the fraudulent or illegal intention to:

- avoid tax and other liabilities, such as employee entitlements
- continue the operation and profit taking of the business through another trading entity.”

What is the cost of phoenix activity?

Phoenix activity has a range of impacts on the Australian economy.³ Employees lose entitlements when phoenix activity has occurred and will often not be paid superannuation; businesses won't have goods and services they have paid for provided or will have debts left outstanding; and government revenue is impacted by phoenix companies not paying tax debts.

A key challenge for this project was quantifying these impacts of phoenix activity. Particular focus was given to quantifying the impact on the industrial relations system and on employees. There is currently a significant lack of data collection on phoenix activity. On the basis of the available data and a series of assumptions that were tested

²Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p1.

³ Ibid.

with stakeholders, the total impact of phoenix activity has been estimated to be \$1.78 – \$3.19 billion per annum.

Table 1: Results of modelling

	Lower bound	Upper bound
Cost to employees	\$191,253,476	\$655,202,019
Cost to business	\$992,314,974	\$1,925,387,263
Cost to government revenue	\$600,770,293	\$610,553,018
Total impact	\$1,784,338,743	\$3,191,142,300

A range of impacts of phoenix activity on employees (such as superannuation), businesses (such as unfair advantage) and government (such as monitoring and enforcement costs) and the environment (such as avoidance of regulatory obligations) have not been included in the modelling. These impacts are discussed qualitatively.

How could phoenix activity be addressed?

A range of actions have been suggested to mitigate phoenix activity. These suggested actions were selected on the basis of:

- proportionality to the scale of the problem
- potential to mitigate phoenix activity
- feedback from stakeholders.

The suggested actions are primarily cross agency options (such as suggested actions 2-6). This reflects that the ATO, ASIC and FWO all work in the space of phoenix activity and any successful strategy to address phoenix activity will involve all the agencies. Suggested actions 7 and 8 are FWO specific options, which have been recommended due to the significant impact of 'phoenixing' on employees.

Three of the suggested actions (suggested actions 9, 10 and 11) involve legislative changes. This is because:

- there was limited support from stakeholders for legislative change beyond those currently being introduced
- there are a range of legislative changes already in train.

Suggested action 1:	The following definition of phoenix activity should be adopted: "Phoenix activity is the deliberate and systematic liquidation of a corporate trading entity which occurs with the illegal or fraudulent intention to: <ul style="list-style-type: none"> • avoid tax and other liabilities, such as employee entitlements • continue the operation and profit taking of the business through another trading entity. "
Suggested action 2:	A cross-agency education campaign should be initiated to educate the community about the indicators of phoenix activity.

Suggested action 3:	Agencies should consider publishing a register of repeat offenders.
Suggested action 4:	Memorandums of Understanding (MOUs) should be signed between the FWO and ASIC and the FWO and ATO that formalise the current cooperative working arrangements.
Suggested action 5:	Cross agency initiatives to improve data collection on phoenix activity should be examined.
Suggested action 6:	Agencies should consider conducting joint phoenix specialist training.
Suggested action 7:	The FWO should further investigate possible proceedings under the <i>Fair Work Act 2009</i> to recover unpaid entitlements from directors of phoenix companies.
Suggested action 8:	The FWO should implement a database for monitoring phoenix activity that would allow better data collection.
Suggested action 9:	That there be consideration of granting the FWO the power to make garnishee orders, or the ability for a person with standing to apply to a court for a garnishee order.
Suggested action 10:	That there be consideration of amendments to the <i>Fair Work Act 2009</i> to include civil remedy provisions to prohibit an employer entering into a transaction with the intention of preventing its employees from recovering their employee entitlements.
Suggested action 11:	The FWO should investigate being granted standing under the <i>Corporations Act</i> to sue on behalf of employees to recover entitlements where the employer has sought to deliberately prevent employees from recovering their entitlements.

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1 Introduction

PwC was engaged⁴ by the Fair Work Ombudsman (FWO) to deliver a report which demonstrates a thorough, evidence based understanding of the impact of phoenix activities on the national workplace relations system.

The project has focused on defining phoenix activity and establishing the scale and significance of the problem of phoenix activity. On the basis of the scale of the activity, a series of suggested actions are made for the allocation of resources to target phoenixing.

As part of this project, consultations with government and non-government stakeholders were undertaken. Appendix A contains a full list of the consultations undertaken and a summary of the findings from these consultations.

1.1 Defining phoenix activity

A key challenge for any analysis or discussion of phoenix activity is how to define the problem. There is currently no definition in Australian legislation. The approach in Australia has been to provide for disqualification of directors in certain circumstances (including incidences of phoenix activity) and set penalties for contravening the disqualification.⁵ However, as described in section 2.2 there have been some recent developments in this area with the release of draft *Corporations Amendment (Similar Names Bill) 2012*. Other jurisdictions, such as New Zealand, have enshrined specific definitions of phoenix activity in legislation with accompanying penalties.

At a basic level, phoenix activity is “the evasion of tax and other liabilities, such as employee entitlements, through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities”.⁶ For the purposes of stakeholder consultation, this was used as a working definition.

The New Zealand Companies Act 1993 defines a phoenix company “in relation to a failed company, a company that, at any time before, or within 5 years after, the commencement of the liquidation of the failed company, is known by a name that is also:

- a) a pre-liquidation name of the failed company, or
- b) a similar name.”

A pre-liquidation name refers to “any name (including any trading name) of a failed company in the 12 months before the commencement of that company’s liquidation” and similar name “means a name that is so similar to a pre-liquidation name of a failed company as to suggest an association with that company”.

⁴ Official Order for Services, 20 May 2011.

⁵ Parliamentary Joint Committee on Corporations and Financial Services 2004, *Corporate Insolvency Laws: a Stocktake*. Available at: http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/report/ail.pdf

⁶ Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p1.

For many years the debate surrounding phoenix activity has struggled with defining the activity. The difficulty in arriving at a definition of phoenix business activity is threefold and due to

- the existence of 'honest' or 'unintended' phoenix activity
- the different methods employed to engage in phoenix activity
- the range of activities which are often described as 'phoenix activity' which are not, strictly speaking, phoenixing.

There are a range of approaches to defining phoenix activity that were identified through analysis and stakeholder consultations. The recommended definition combines a range of the potential approaches:

- corporate form definition
- liability definition
- indicator definition
- name based definition
- criminal conduct definition.

1.2 Establishing the scale and cost of phoenix activity

In order to ensure that the options to address phoenix activity are targeted and proportional, the scope of the problem of phoenix activity must be understood.

In 1996, the Australian Securities Commission (ASC, now ASIC) quantified the annual loss to Australian businesses due to phoenix activity as \$670 million to \$1.3 billion.⁷ This is likely to have increased significantly as the ATO reports that phoenix activity has been on the rise amongst larger businesses.⁸

In order to ensure that the quantification was robust and defensible, a model was constructed that draws, as much as possible, on existing data. Where there was not reliable data, assumptions have been made based on feedback from stakeholders. Due to the uncertainty surrounding these assumptions, lower and upper bound estimates were used in the quantification. The assumptions were also subject to a range of sensitivity tests.

Based on this method, it is estimated that phoenix activity costs Australian employees \$191 to \$655 million per annum and the overall impact of phoenix activity is estimated as \$1.78 to \$3.19 billion per annum.

⁷ Australian Securities Commission 1996, Research Paper No 95/01- *Phoenix Companies and Insolvent Trading*, Canberra.

⁸ Department of Finance, 2011. *Regulation Impact Statement for Taxation Changes to Address Fraudulent Phoenix Activity*, p 2.

1.3 Suggested actions to address phoenix activity

There have been a range of options identified by previous works on phoenix activity, such as the Cole Inquiry and Treasury's *Action Against Fraudulent Phoenix Activity: Proposals Paper*.

In consultations with stakeholders a range of cross agency, FWO and legislative options for addressing phoenix activity were discussed. These options, as well as the feedback received, are summarised in section 5.2. Actions have been suggested based on:

- stakeholder feedback
- the scale of the problem
- the potential to be successful in mitigating phoenix activity.

The suggested actions are primarily cross agency. This is because the ATO, ASIC and FWO all work in the space of phoenix activity. Therefore, any successful strategy to address phoenix activity will involve all the agencies. A range of suggested actions for the FWO to address phoenix activity are also detailed due to the significant impact of phoenixing on employees.

2 *Overview of phoenix activity*

Phoenix activity is not a recent phenomenon. Since the corporate form has existed, it has been manipulated and used to avoid liabilities. Phoenix activity, like the mythical creature from which it takes its name, involves the winding up of a company and the subsequent continuation of the business in a new ‘risen’ company.⁹

2.1 Previous work on phoenix activity

To date there have been a range of studies and inquiries that directly addressed phoenix activity or devoted significant attention to the issue of phoenix activity, including:

- the Law Reform Committee of the Parliament of Victoria (1993) examination of phoenix companies
- the ASC (1996), *Phoenix Activities and Insolvent Trading*
- the Royal Commission into the Building and Construction Industry (2003)
- the Treasury (2009), *Action against Fraudulent Phoenix Activity: Proposals Paper*

The 1996 ASC study sought to understand the impact insolvent and phoenix trading activities have upon small to medium enterprises (SMEs) and establish a predictive model for insolvent trading and phoenix activities.¹⁰ As part of this study a telephone survey was conducted to quantify the impact of phoenix activity on businesses in Australia. It was estimated that phoenix activity costs Australian businesses \$0.67 to 1.3 billion per year.¹¹

The Royal Commission into the Building and Construction Industry, commonly referred to as the Cole Inquiry, considered phoenix activity amongst a range of issues. The Inquiry concluded that there was ‘significant incidence’ of phoenix activity in the industry.¹² The Commission made a series of recommendations to address phoenix activity including

- information sharing between the ASIC and the ATO with a view of diminishing phoenix company activity
- information sharing between Commonwealth and State and Territory revenue authorities to share information relevant to detecting payroll evasion
- amendments to the *Pay Roll Tax Act* 1971 to make all members of a group of companies jointly liable for payroll tax debts of other group members

⁹ The Australia Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p 1.

¹⁰ Barlow, Darren 1996, *Phoenix Activities and Insolvent Trading, prepared for the Australian Securities Commission*, p 10.

¹¹ Ibid.

¹² *Royal Commission into the Building and Constructions Industry*, p 108.

- that the Commonwealth establish guidelines of the responsibilities of the ASIC and the ATO in relation to phoenix activity and the agencies be given appropriate resources to address phoenix activity.¹³

In 2009 the Australian Treasury prepared a proposal paper, *Action against Fraudulent Phoenix Activity*. The paper summarised the challenges that phoenix activity presents in the collection of tax revenue and other employee entitlements and presented a range of case studies. A series of proposals for reforming taxation and corporations law were also proposed in the paper including, but not limited to:

- amending the director penalty regime
- expanding the director penalty regime
- amending the promoter penalty regime
- expanding anti-avoidance provisions
- denying PAYG (W) credits
- implementing bond provisions
- expanding the scope for disqualifying directors.¹⁴

2.2 Recent developments in mitigating phoenix activity

Since these previous works, there have been significant developments in mitigating phoenix activity.

Following Treasury's 2009 proposal paper the government committed to a range of measures to mitigate the incidence of phoenix activity. In July of 2011 draft legislation was released which amended tax law in order to:

- expand the director penalty regime to superannuation guarantee amounts
- enable the ATO to commence recovery of a director penalty without providing a 21 day grace period where the company's unreported PAYGW and/or superannuation guarantee debt is over three months old restricting access to Pay As You Go (PAYG) withholding credits for company directors and their associates where the company has failed to pay withheld amounts to the Commissioner.¹⁵

Further legislation was introduced into Parliament on 13 October 2011. The *Corporations Amendment (Phoenixing and Other Measures) Act 2012* received Royal Assent on 26 May 2012. This Act amends the Corporations Act to provide ASIC the administrative power to wind up companies that have been abandoned (i.e. those no longer trading but have not liquidated). This is intended to assist employees with outstanding employment entitlements to access GEERS.

¹³ Ibid, p 109-11.

¹⁴ The Australia Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p13-21.

¹⁵ The Treasury, 2011. *Exposure Draft- Tax Law Amendments to Strengthen Company Director Obligations and Deter Fraudulent Phoenix Activity*. Available at: <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=2073>

The *Corporations Amendment (Similar Names) Bill 2012* intends to amend the Corporations Act to provide that a director of a failed company can be jointly and individually liable for the debts of a company that has a similar name to a pre-liquidation name of the failed company. An Exposure Draft of this Bill was released and submissions closed on 29 February 2012. The Bill has not yet been introduced to Parliament.

Outside of legislative change, there have also been a range of cross agency and interagency efforts to mitigate phoenix activity. These include ongoing information exchange between a number of agencies via MOUs, the commencement of a working forum between various agencies including the ATO, ASIC and the FWO in respect of phoenix activity and ongoing dialogue about the issue of phoenix activity. The FWO is exploring the ability to enter into an MOU with ASIC which will assist in information exchange between those agencies. However, the interagency forum is still in preliminary stages and the FWO is yet to finalise MOUs with either ATO or ASIC.

3 Defining phoenix activity

The Parliamentary Joint Committee on Corporations and Financial Services noted that it is very difficult, if not nearly impossible, to precisely define fraudulent phoenix activity.¹⁶

As already described, phoenix activity involves “the evasion of tax and other liabilities, such as employee entitlements, through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities”.¹⁷ However, a range of other activities that can be considered deceptive are often referred to as phoenix activity. Additionally, companies can liquidate and later honestly be revived.

It is the recommendation of this report that the following definition of phoenix activity be used:

Phoenix activity is the deliberate and systematic liquidation of a corporate trading entity which occurs with the illegal or fraudulent intention to:

- *avoid tax and other liabilities, such as employee entitlements*
- *continue the operation and profit taking of the business through another trading entity.*

Liabilities may also include contractual or statutory obligations and civil or criminal proceedings.

3.1 Existing definitions of phoenix activity

The Treasury proposal paper defined phoenix activity as “the evasion of tax and other liabilities, such as employee entitlements, through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities”... this was used as the working definition for this project.

The Australian Securities and Investment Commission (ASIC) identified three key characteristics of phoenix activity:

- a company fails and is unable to pay its debts, and/or
- acts in a manner which intentionally denies unsecured creditors equal access to the available assets in order to meet and pay debts
- within 12 months of closing, another business commences which may use some or all of the assets of the former business and is controlled by parties related to either the management or directors of the previous company.

The Treasury proposal paper defined phoenix activity as “the evasion of tax and other liabilities, such as employee entitlements, through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities”.¹⁸ This was used as the working definition for this project, and broadly stakeholders felt it was appropriate.

¹⁶ Parliamentary Joint Committee on Corporations and Financial Services 2004, *Corporate Insolvency Laws: A Stock take*, p131.

¹⁷ Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p1.

¹⁸ *Ibid.*

The New Zealand *Companies Act 1993* defines a phoenix company “in relation to a failed company, a company that, at any time before, or within five years after, the commencement of the liquidation of the failed company, is known by a name that is also:

- a) a pre-liquidation name of the failed company, or
- b) a similar name.”

A pre-liquidation name refers to “any name (including any trading name) of a failed company in the 12 months before the commencement of that company’s liquidation” and similar names “means a name that is so similar to a pre-liquidation name of a failed company as to suggest an association with that company”.

3.2 Key considerations in defining phoenix activity

In determining an appropriate definition of phoenix activity, there are a range of considerations that must be accounted for. The key considerations are:

- that there are a number of common indicators of phoenix activity that some stakeholders felt should be included in any definition of phoenix activity
- any definition must seek to differentiate between fraudulent phoenix activity and the honest resurrection of a company
- the nature of phoenix activity is constantly evolving and a definition of phoenix activity must remain relevant, despite changes
- there are a range of activities that are often referred to as phoenix activity, but do not fit many of the existing definitions of phoenix activity.

Indicators of phoenix activity

Stakeholders noted that there are a range of ‘signals’ or ‘indicators’ that phoenix activity may be about to occur. These generally occur before the company has been liquidated and thus, can be considered leading indicators of phoenix activity. These indicators include:

- the company fails to lodge tax returns and/or Business Activity Statements
- the business records and/or taxation records significantly understate or overstate the operations of the business, including debts owed
- withheld payments such as PAYGW, superannuation and child support payments are kept by the business
- workers are pressured to take leave
- workers have their employment status changed from permanent to casual
- workers are underpaid
- equipment, machinery and uniforms are not replaced as needed.

Stakeholders also noted that there are a range of common signs that a business has already engaged in phoenix activity. These lagging indicators of phoenix activity can include:

- the directors of the new entity are family members of the director of the former company or are close associates, such as managers, of the former business

- a similar trading name is used by the new entity
- the same business premises and telephone number (particularly mobile number) are used by the new entity.

Many stakeholders argued that it would be useful, particularly for people with limited knowledge of phoenix activity, for any definition to include reference to these indicators.

Distinguishing between phoenix activity and honest behaviour

There are circumstances where a business has been managed responsibly and fails, and after a period of time, its directors are able to continue operating the business under another corporate entity. This is not, in and of itself, an illegitimate use of the corporate form.¹⁹ For example, a business may go into administration and in the case of many high risk businesses “assets, equipment, and even the business itself are largely unsaleable and consequently a liquidator will often end up disposing of the assets of the failed company to directors of the company who hope to resurrect the business with reserved personal finances”.²⁰

The key distinction between fraudulent phoenix activity and the honest resurrection of a company is the intent with which the liquidation is undertaken.²¹ Fraudulent phoenix activity involves the liquidation of a company in order to avoid debts with the full intention of continuing the business after the liquidation. Fraudulent phoenix activity also usually involves the intentional structuring of a company in a way that allows directors to avoid meeting their obligations to pay taxes, employee entitlements and debts owed to other businesses.²²

Stakeholders all highlighted that any definition must stress the deliberateness or intent with which a fraudulent phoenix business liquidates in order to avoid debts. It was also emphasised that in cases of honest behaviour, the revival of businesses should not be discouraged.

Some stakeholders (such as the ATO) used the term ‘fraudulent phoenix activity’ to distinguish between the manipulation of the corporate form to avoid debts and the honest ‘resurrection’ of a company that had been liquidated (which was sometimes referred to as ‘honest’ phoenix activity). Other stakeholders used the term phoenix activity to describe the liquidating of a company to avoid debts and used other terms for the honest resurrection of a company.

Phoenix activity and phoenix-like activities

Many activities are referred to as “phoenixing” which do display phoenix-like characteristics, in that debts are avoided; however they do not directly fit the definition of phoenixing. These behaviours are sometimes referred to as false designation, sham contracting and misrepresentation.

19 Department of Finance, 2011. *Regulation Impact Statement for Taxation Changes to Address Fraudulent Phoenix Activity*, p1.

20 Royal Commission into the Building and Constructions Industry

21 Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p1.

22 *Ibid*, p1.

An issue that is interlinked to, but distinct from, phoenix activity is sham contracting. Sham contracting is where a person is employed as a contractor so that paying legal minimum wages, tax and entitlements can be avoided.²³ Feedback from stakeholders suggest that sham contractors will often not pay taxes and when they are audited by the ATO have outstanding tax debts of up to \$15,000. The sham contractor will then engage in phoenix activity to avoid this tax debt. It is also recognised that sham contractors will not usually have any employees.

The evolving nature of phoenix activity

The literature on phoenix activity and the stakeholders consulted in this project emphasised that phoenix activity has evolved significantly over the past decade.

Multiple stakeholders emphasised that phoenix activity is not confined to the building and construction industry or the lower end of the SME sector as it perhaps once was. Stakeholders noted the rise of phoenix activity in the cleaning and private security industries, with one stakeholder describing phoenixing in the private security industry as being at endemic proportions.

Multiple stakeholders observed that it is often suspected that financial advisers, lawyers and insolvency practitioners are involved in some incidents of phoenix activity. This issue was raised in the Parliamentary Joint Committee on Corporations and Financial Services *Stocktake of Corporate Insolvency Laws*.

Phoenix activity has also evolved in terms of the forms it can take. In the early 1990s the most common forms of phoenix activity were where a company would incur debt in the form of employee entitlements, to creditors and for outstanding tax. Consequently, the business would go into liquidation or administration. The directors of the company would then form a new entity, often using some or all of the assets of the former company and often the same business name. This is commonly referred to as 'asset stripping'.

Recently, a more common arrangement is for a group of companies to be formed, where each primary business function is operated through a separate entity.²⁴ One of the entities will supply labour to the entire group and will have relatively few or no assets. The labour entity withholds taxes and incurs debts and is declared insolvent without affecting the assets held elsewhere in the group. A new labour supply entity will be created and workers are transferred to this entity with little or no interruption to the day-to-day operations of the business.

3.3 Possible approaches to defining phoenix activity

There are a number of approaches to defining phoenix activity that could be used. These approaches are summarised below. It should be noted that these approaches are not necessarily mutually exclusive and combinations of these approaches could be used.

²³ Fair Work Ombudsman 2011, *Sham Contracting Case Studies*. Available at: <http://www.fairwork.gov.au/employment/independent-contractors/sham-contracts/sham-contracting-case-studies/pages/default.aspx>

²⁴ ATO, 2009. *Targeting Tax Crime: A Whole of Government Approach*, p15.

Corporate form based definition

As phoenix activity entails the manipulation of the corporate form, it can be defined in these terms. A definition could specify the common manipulations of the corporate form that companies use to engage in phoenix activity. For example, ASIC identifies three common characteristics of phoenix activity including “within 12 months of closing, another business commences which may use some or all of the assets of the former business and is controlled by parties related to either the management or directors of the previous company”. Such a definition could include reference to the asset stripping of the former business and the transfer of the assets to the new business as well as the other common forms of phoenix activity such as the liquidation of the labour hire entity.

There are some limitations to such a definition. A number of years ago, asset stripping was very common in phoenix activity. However anecdotal evidence suggests it is now less so, though it is recognised that stakeholders such as ASIC still consider asset stripping as a key element of phoenix activity. The FWO have indicated that they do not consider asset stripping as necessarily determinative.

It is now common for the liquidated company to be the ‘services’ entity within a group of entities that form the company and for it to have few, if any, assets. The dynamic nature of phoenix activity would mean that a corporate form based definition would have to withstand the changes in phoenix activity or be updated to evolve with phoenix activity.

Liability based definition

The definition used by Treasury, and used as a working definition for this project, focuses on the intent with which phoenix activity is undertaken. A strength of such a definition is that it distinguishes between honest behaviour and phoenix activity.

Additionally, in not specifying how the corporate form is manipulated it would not need to be updated to keep pace with the evolution of phoenix activity. However, it is perhaps not useful in providing clarity for those with little familiarity with phoenix activity or corporate law.

Indicator based definition

Many stakeholders emphasised the importance of educating the community about the signs or indicators of phoenix activity. A definition could be framed around the common indicators listed in section 3.2. This is similar to the ASIC definition which identifies three key characteristics of phoenix activity. However, like the corporate form based definition, an indicator definition may become outdated as phoenix activity evolves.

Name based definition

The approach taken in New Zealand has been to define phoenix activity in terms of the re-use of the name, or a name similar, to the former company. Such a definition is simple, making it easily understandable and interpretable for the community.

However, many stakeholders noted that a name based definition (such as that enshrined in legislation in New Zealand) is quite ‘superficial’ in that it defines phoenix activity in terms of one of the common indicators, and does not address many of the other indicators. It was also highlighted that such an approach could create a moral hazard whereby companies still engage in phoenix activity, however change their name significantly in order to avoid fitting the legislative definition of phoenix activity. Additionally in some industries, for example the building and construction industry,

the trading name is not of significant importance and therefore, is not always reused in cases of fraudulent phoenix activity.

Criminal conduct definition

Master Builders argued that the definition of phoenix activity should focus on the existing sections of corporations law and criminal law that fraudulent phoenix activity breaches. It was proposed that any definition of phoenix activity should focus on the criminality of the activity. A key flaw in such an approach to defining phoenix activity is that there are a range of civil remedies to deal with phoenix activity under the Corporations Act and therefore, phoenix activity is not just characterised by criminal conduct.

Using multiple definitions

In order to clarify the use of the term phoenix activity, it was suggested that multiple terms with accompanying definitions could be used. For example, one term could be used to describe fraudulent phoenix activity, another term for honest phoenix activity and a range of definitions for phoenix-like behaviour.

In their submission to the Cole Royal Commission and their 1996 research paper on phoenix activity, ASIC differentiated between honest behaviour and fraudulent phoenix behaviour by analysing phoenix behaviour in terms of 'innocent phoenix operators', 'occupational hazard' and 'careerist offenders'.

Innocent phoenix operators, as already described, are businesses that get into a position of doubtful solvency or insolvency due to poor business practices. The business is later able to be revived and this typically involves no contravention of the law.

Occupational hazard refers to the potentially heightened risk in some industries, such as the building and construction industry, of phoenix activity. Once a company has collapsed, the operators of the business may have little option but to return to the same industry in the form of a new business. In the case of construction, the business may have few assets, such as tools and a vehicle. The assets may be made available to creditors and therefore, no contravention of the law has occurred.

ASIC described what they termed 'careerist offenders' as those that purposefully structure their operations in order to engage in fraudulent phoenix activity and avoid detection.

3.4 Suggested definition of phoenix activity

There are many alternative and complementary approaches that can be taken to define phoenix activity, each with its own strengths and weaknesses. Based on feedback from government and non-government stakeholders and PwC's own assessment, the two approaches that are considered optimal are the liability based definition and the indicator based definition. Based on these optimal approaches, the following definition of phoenix activity is recommended. It is also suggested that a series of indicators of phoenix activity accompany the definition so that it is meaningful and useful for those with a limited knowledge of phoenix activity.

Suggested action 1:

Phoenix activity be defined as the deliberate and systematic liquidation of a corporate trading entity which occurs with the fraudulent or illegal intention to:

- avoid tax and other liabilities, such as employee entitlements, and
- continue the operation and profit taking of the business through another trading entity.

Phoenix activity can also involve, though does not always involve:

- the continuation of the operation of the business under the same name
- the directorship of the new company being held by a close associate of the director of the former company
- employees of the former company continuing to be employed by the new company, and/or
- the liquidation of one company within a group of companies.
- the avoidance of liabilities can include contractual or statutory obligations and civil or criminal proceedings.

The definition outlined above has a number of strengths:

- the definition highlights the intent with which phoenix activity is undertaken and therefore, differentiates between the honest resurrecting of a company and dishonest phoenix activity
- the definition does not specify the methods by which the manipulation of the corporate form is achieved and therefore, will not become quickly out of date as phoenix activity evolves.

Many stakeholders noted that any definition should be easily understood by the community and assist them in identifying phoenix activity. For this reason, the definition is accompanied by a small number of indicators of phoenix activity. There are a significant number of indicators, both leading and lagging, that could have been included. It is considered that the indicators selected are those that will assist the community in identifying phoenix activity and that are most common to the incidence of phoenix activity.

It is recognised that there may be a limited number of instances of businesses that are not incorporated but are engaging in phoenix activity. However, the FWO have indicated that the majority of instances the FWO encounters do not involve businesses that are not incorporated and do not involve personal bankruptcy.

4 Establishing the scale and cost of phoenix activity in 2009/10

In order to ensure that the suggested actions are proportional to the problem, a key focus of this project has been quantifying the impact of phoenix activity on employees. There is a significant lack of data on the incidence of phoenix activity and its impact. This is largely the result of the difficulty in identifying cases of phoenix activity and the lack of data collection conducted.

The ASC 1996 research project estimated that approximately 9,000 individual businesses may be affected by phoenix activities per annum.²⁵ However, it did not seek to quantify the number of businesses engaging in phoenix activity.

There have not been any previous attempts to quantify the impact of phoenix activity on employees or the economy as a whole. The 1996 ASC estimate, which is often cited, sought only to quantify the impact of phoenix activity on businesses and not the other impacts of phoenix activity.

To quantify the impact of phoenix activity on employees a 'risk-based' model was constructed. Based on stakeholder feedback and literature review, a number of industries were identified as being at risk of phoenix activity. Each industry was then ascribed a 'risk rating' (low risk, medium risk or high risk). This was used to extrapolate the number of employees affected by phoenix activity per annum.

Due to the uncertainty surrounding the data, a range of sensitivity tests were conducted such as increasing and decreasing the loss per employee and using different estimates of the number of phoenix companies. An estimate of the impact on employees was also modelled using publicly available Dunn & Bradstreet (D&B) data to sense-check the risk based approach.

The estimate of the impact of phoenix activity is for the 2009/10 financial year. This is because data was not available for many items for the 2010/11 financial year.

There are a range of impacts of phoenix activity that may be significant but that could not be quantified with existing data. These impacts are qualitatively described in section 4.5.

²⁵ Australian Securities Commission 1996, Research Paper No 95/01- Phoenix Companies and Insolvent Trading, Canberra, p86.

4.1 Results

Table 2: Results of modelling

	Lower bound	Upper bound
Cost to employees	\$191,253,476	\$655,202,019
Cost to business	\$992,314,974	\$1,925,387,263
Cost to government revenue	\$600,770,293	\$610,553,018
Total impact	\$1,784,338,743	\$3,191,142,300

It is estimated that phoenix activity costs employees \$191 to \$655 million per year and that the cost to employees makes up 10% to 20% of the total cost of phoenix activity.

Assumptions

The following section details the modelling which was used to quantify phoenix activity.

A range of assumptions were used in the model for quantifying phoenix activity. These assumptions are based on the most robust available sources and are listed below.

Table 3: Assumptions

Assumption	Parameter	Source
Average loss per employee from phoenix activity	\$9,897.76	Average payment made to claimants under the General Employee Entitlements and Redundancy Scheme (GEERS) in 2009/10 ²⁶
Loss to employees from phoenix activity per phoenix company	\$82,916.40	Average payment made to claimants per business under GEERS in 2009/10 ²⁷
Number of companies liquidated in 2009/10	10,200	Dunn & Bradstreet data ²⁸

It is noted that GEERS does not pay all outstanding employee entitlements when an employer enters liquidation or bankruptcy. Assistance for unremitted employer superannuation is not available and there is a significant lack of data on non-compliance with superannuation payments and the impact of phoenix activity on

²⁶ Provided in consultations with GEERS

²⁷ Ibid.

²⁸ Sydney Morning Herald 2010, *A Rise from the Ashes of Others*, December 11, 2010. Available at: <http://www.smh.com.au/business/a-free-rise-from-the-ashes-of-others-20101210-18std.html>

superannuation. A sensitivity test has been included in section 4.2 to run the model with superannuation included.

Additionally, sick or personal leave is not payable under GEERS and employees would lose any personal leave accrued where phoenix activity occurs.

A number of entitlements are also capped under GEERS:

- unpaid wages are capped at three months
- payment in lieu of notice is capped at five weeks
- redundancy pay is capped:
 - prior to 1 January 2011 – at 16 weeks (which is relevant for the period of data referred to in this report).
 - after 1 January 2011 – at four weeks per year of service.
- annual salary – where a claimant earns more than the GEERS maximum annual wage (\$118,100 for 2011-12), their GEERS payment will be calculated as if they earned that amount.

These caps and the unavailability of assistance for some entitlements means that the GEERS data will understate the true impact of phoenix activity on employees.

The period for which the GEERS data has been taken, 2009/10, was prior to recent changes to GEERS. Under these changes the protection for redundancy increased where liquidation and bankruptcy occurred after 1 January 2011 and assistance for redundancy is now capped at a maximum of four weeks per year of service.

4.2 Impact on employees

A key focus of this project has been quantifying the impact of phoenix activity on employees. A risk based model was constructed and a range of sensitivity tests applied.

Risk based approach

It was clear in consultations with stakeholders that phoenix activity is concentrated in a relatively small number of industries. The following industries were identified as 'at risk' of phoenix activity. It is not suggested that the industries listed are the only industries in which phoenix activity occurs. However, by ascribing a risk rating to only those industries considered 'at risk' a conservative estimate will be arrived at.

Table 4: Risk profile of industries

At risk industry	Risk profile
Building and construction ¹	Medium risk
Private security	High risk
Cleaning	High risk
Road transport	Medium risk
Retail telecommunications	Low risk
Textiles, clothing and footwear manufacturing	Medium risk
Metal manufacturing	Low risk
Restaurants and cafes	Low risk

At risk industry	Risk profile
<p>Note 1: Building and construction</p> <p>Feedback from stakeholders indicated that phoenix activity remains a significant problem in the building and construction industry. Sections of the building and construction industry, such as bricklaying, appear to have significant incidence of phoenix activity and such sections would be classified as 'high risk'. However, the data for the industry captures these high risk sections of the industry, as well as lower risk sections. For this reason building and construction has been classified as 'medium' risk, though there are sections of the industry that are considered 'high risk'.</p> <p>Additionally, increasing the risk profile of building and construction results in a significant increase in the impact on employees due to the significant employment in the industry. This also contributed to the decision to profile building and construction as medium risk. A sensitivity test has been conducted of increasing the risk rating of building and construction to high risk.</p>	
<p>Note 2: Labour hire industry</p> <p>Stakeholders highlighted that phoenix activity is a significant issue in the labour hire industry (where companies provide labour to other companies on a contract basis). The inclusion of labour hire as an 'at risk' industry was considered. However, it was decided that the industry could not be robustly included because:</p> <ul style="list-style-type: none">• there is no reliable data on the number of operators or employees in the industry• there is a risk of double counting. <p>Labour hire companies commonly provide workers in the cleaning and private security industry. Including labour hire as a separate industry may lead to double counting as employees counted in the cleaning and private security industry may also be counted in the labour hire industry.</p>	
<p>Note 3: Property development industry</p> <p>According to stakeholders there is a notable risk of phoenix activity in the property development industry that would justify its inclusion as an 'at risk' industry. Including property development was considered, however, there is not data available on employment in the property development industry. There was also insufficient information available to make reasonable assumptions around the number of employees working in property development. If the property development industry were to be included it would be ascribed a medium or high risk rating.</p>	

A risk parameter was applied to each risk rating. These parameters are an estimate of the proportion of employees in the industry who are affected by phoenix activity per annum. These risk parameters (see Table 5) were estimated based on feedback and consultation with stakeholders.

There are a significant number of business entries and exits in these industries and as a consequence there are significant fluctuations in the data of the number of businesses. Therefore, it was decided to ascribe a risk to the number of employees for which the data is more stable rather than ascribing a risk to the number of businesses.

The risk parameters seek to capture only people employed by a phoenix company and do not seek to include employees of companies affected by phoenix activity. Due to the uncertainty, a lower bound and upper bound estimate of the risk parameter was ascribed to each risk rating.

Table 5: Risk parameters

Risk parameters		Lower bound	Upper bound
Proportion of employees in industry effected by phoenix activity per annum	Low risk	0.5%	2.5%
	Medium risk	1.5%	5%
	High risk	3%	10%

Based on these risk profiles and parameters a lower bound and upper bound estimate of the impact on employees was calculated.

Lower bound

Table 6: Lower bound estimate of cost to employees

Industries	Employment in Industry	Cost per employee of phoenix activity	Risk profile	% of employees impacted by phoenix activity	Impact on employees
Building and construction	706,400 ²⁹	\$9,897.76	Medium risk	1.5%	\$104,876,665
Private security	14,500 ³⁰	\$9,897.76	High risk	3%	\$4,305,526
Cleaning	95,001 ³¹	\$9,897.76	High risk	3%	\$28,208,913
Road transport	243,900 ³²	\$9,897.76	Medium risk	1.5%	\$36,210,955
Retail telecommunications	9,338 ³³	\$9,897.76	Low risk	0.5%	\$462,126
Textile, leather, clothing and footwear manufacturing	47,399 ³⁴	\$9,897.76	Medium risk	1.5%	\$7,037,159
Metal and metal product manufacturing	59,594 ³⁵	\$9,897.76	Low risk	0.5%	\$2,949,236
Restaurants and cafes	145,546 ³⁶	\$9,897.76	Low risk	0.5%	\$7,202,897
				Total	\$191,253,476

²⁹ Australian Bureau of Statistics, 2010. *2009/10 Year Book Australia*.

³⁰ Based on feedback from stakeholders.

³¹ Australian Bureau of Statistics, 2010. *2009/10 Year Book Australia*.

³² Australian Bureau of Statistics, 2010. *2009/10 Year Book Australia*.

³³ Ibid.

³⁴ Australian Bureau of Statistics, 2010. 8159.0 *Estimates for the Manufacturing Industry 2008/09*.

³⁵ Ibid.

³⁶ Australian Bureau of Statistics, 2008. 8655.0 Cafes, Restaurants and Catering Services.

Upper bound

Table 7: Upper bound estimate of cost to employees

Industries	Employment in Industry ³⁷	Cost per employee of phoenix activity	Risk profile	% of employees impacted by phoenix activity	Impact on employees
Building and construction	706,400	\$9,897.76	Medium risk	5%	\$349,588,883
Private security	14,500	\$9,897.76	High risk	10%	\$14,351,752
Cleaning	95,001	\$9,897.76	High risk	10%	\$94,029,710
Road transport	243,900	\$9,897.76	Medium risk	5%	\$120,703,183
Retail telecommunications	9,338	\$9,897.76	Low risk	2.50%	\$2,310,632
Textile, leather, clothing and footwear manufacturing	47,399	\$9,897.76	Medium risk	5%	\$23,457,196
Metal and metal product manufacturing	59,594	\$9,897.76	Low risk	2.50%	\$14,746,178
Restaurants and cafes	145,546	\$9,897.76	Low risk	2.50%	\$36,014,484
				Total	\$655,202,019

³⁷ As for Table 6.

Based on the risk based approach, phoenix activity approximately costs Australian employees \$191– \$655 million per annum.³⁸

As shown in Tables 6 and 7 the building and construction industry contributes significantly to the impact on employees. This is due to the significant level of labour concentration in the industry. Road transport also contributes significantly to the total impact of phoenix activity on employees also due to the significant level of labour concentration in the industry.

Sensitivity testing

Due to the uncertainty surrounding the impact of phoenix activity, a range of sensitivity tests have been conducted to test the estimate.

Dunn & Bradstreet data

In 2010, D&B conducted analysis of liquidated companies and phoenix companies for the Sydney Morning Herald's Weekend Business.³⁹ They found that of the 10,200 companies that were liquidated in the 2009/10 financial year, 29% had one or more directors previously involved with a liquidated entity and 20% had directors associated with two or more liquidated entities.

Table 8: Dunn and Bradstreet data 2009/10

Number of companies liquidated	10,200
Director in 1 previous liquidation	29%
Director in 2 or more previous liquidations	20%

It is recognised that there may be companies who have only liquidated once and engaged in phoenix activity. However, feedback from stakeholders indicated that phoenix operators are usually 'serial' offenders in that they will repeatedly liquidate a company. Feedback from government agencies also suggests that they start to suspect that phoenix activity may be occurring when a director has been involved in 3 company failures.

Lower, mid and upper bound estimates of the proportion of liquidated companies engaging in phoenix activity were applied to the D&B data. These estimates were formed based on feedback from stakeholders and 'sense checked' against other estimates of the number of companies engaging in phoenix activity (see Table 11).

Table 9: Number of companies engaging in phoenix activity 2009/10

	Proportion of liquidated companies engaged in phoenix activity	Number of companies engaged in phoenix activity
Lower bound	3.5%	357

³⁸ Noting that this does not include superannuation payments and that some of this impact may be remitted to employees through GEERS payments.

³⁹ Sydney Morning Herald 2010, *A Rise from the Ashes of Others*, December 11, 2010. Available at: <http://www.smh.com.au/business/a-free-rise-from-the-ashes-of-others-20101210-18std.html>

	Proportion of liquidated companies engaged in phoenix activity	Number of companies engaged in phoenix activity
Core	7%	714
Upper bound	15%	1,530

Calculated using GEERS data, it was estimated that the loss to employees per phoenix company is \$82,916.40. The results of the model using the D&B data are summarised in Table 10.

Table 10: Estimate of cost to employees from phoenix activity 2009/10 using D&B data

	Lower	Mid	Upper
Cost to employees per annum	\$29,601,154	\$59,202,309	\$126,862,092

This model results in a significantly lower estimate of the impact of phoenix activity on employees than the risk based approach. This does not invalidate the risk based approach. There are a range of reasons that this model may significantly understate the impact of phoenix activity.

- Not all companies who engage in phoenix activity will liquidate the company. Often the company through which the business was operated will be stripped of its assets and continue existing, though not actively operating. It is recognised that these companies will often be wound up by action of the ATO over time and/or deregistered by ASIC for failure to pay annual fees and/or lodge documents.
- Many serial phoenix operators will not be director of the companies that are liquidated, but will have family members or close associates as the director of the company (though this is only 'on paper' and the phoenix operator will run the day-to-day operations of the business).
- There would be a number of companies engaging in phoenix activity that liquidate only once, and these companies would not be captured in this estimate. Feedback from stakeholders indicates that there would only be a very small number of cases where this occurs.

The D&B data does not capture any of these scenarios and therefore, it is reasonable to believe that the impact that has been quantified significantly understates the true impact of phoenix activity.

Additionally, the ATO estimates that approximately 6,000 companies in Australia have engaged in phoenix activity. The upper bound estimate of the number of companies engaged in phoenix activity based on D&B data is significantly less than this.

The difference in these estimates reflects the uncertainty that exists surrounding the number of companies engaging in phoenix activity and indicates that further research and greater data collection is needed (see suggested action 7).

Government estimate of the number of phoenix operators

Former Assistant Treasurer Bill Shorten has cited estimates, based on ATO expertise, that there are 6,000 phoenix operators in Australia.⁴⁰ It is recognised that this estimate is a ‘global’ estimate not an annual estimate of the number of phoenix operators. Therefore, it is reasonable to think that there may in fact be less than 6,000 incidents of phoenix activity per year. However, this estimate is the only existing estimate of the number phoenix operators in Australia. Therefore sensitivity testing was conducted of the impact of phoenix activity on employees using the assumption that there are 6,000 phoenix operators.

Table 11: Sensitivity testing of government estimate of phoenix operators

Number of phoenix companies	6,000
Loss to employee per phoenix company	\$82,916.40 ⁴¹
Loss to employees per annum	\$497,498,400

As shown in Table 11, the impact of phoenix activity is estimated to be \$497 million per annum.

This is within the range of the estimates of the impact of phoenix activity using the risk based approach ie. \$193 -661 million per annum.

Increasing the risk rating of building and construction

Stakeholders indicated that there is a significant risk of phoenix activity in the building and construction industry. Some stakeholders felt that the risk was such that the industry should be ascribed a risk rating of high risk. As already described, it was decided to rank the building and construction industry as medium risk in the core modelling due to:

- the concentration of risk in parts of the building and construction industry
- the high levels of employment in the industry meaning that any increase in the risk rating has a significant impact on the results (as shown below).

Sensitivity analysis was conducted of increasing the risk rating to high risk.

Table 12: Sensitivity testing of risk rating of building and construction

Risk rating of building and construction	Cost to employees Lower bound	Cost to employees Upper bound
High risk	\$296,130,141	\$1,004,790,902

⁴⁰ Yeates, Clancy 2011. *Warning Phoenix Law May Burn Innocent*. The Age- Business Day, November 1, p. 21.

⁴¹ Provided in consultations with GEERS

Due to the significant employment in the building and construction industry, increasing the risk rating has a significant impact on the results.

Other sensitivity tests

A range of other sensitivity tests were applied to different assumptions and parameters.

Impact on employees

The sensitivity of results to changes in the impact on employees was tested.

Table 13: Sensitivity testing of impact on employees

Item for testing	Parameter	Cost to employees Lower bound	Cost to employees Upper bound
50% impact on employees	\$4,949	\$95,626,738	\$327,601,009
150% impact on employees	\$14,847	\$286,880,214	\$982,803,028
Inclusion of superannuation	\$10,789	\$208,466,289	\$714,170,200

The compensation provided by GEERS does not include superannuation payments. Stakeholders emphasised that one of the significant impacts of phoenix activity for employees is on their superannuation, as often payments will not have been made for extended periods. In order to include the impact of superannuation, the impact on employees was modelled as \$10,780 which is the GEERS compensation per employees plus 9% (the compulsory superannuation payment).

It is recognised that there are limitations to using the GEERS data to estimate superannuation payments not remitted due to phoenix activity. Firstly, given the restrictions placed on GEERS entitlements the average amount paid will not necessarily be the full entitlement owed upon liquidation or bankruptcy. Secondly, GEERS experience has shown that in circumstances of insolvency many employers do not pay superannuation for a period prior to the liquidation and bankruptcy. GEERS payments do not take account of this, particularly as assistance for unpaid wages is limited to three months.

There are a number of alternative sources that could be used to quantify the impact of phoenix activity on employees' superannuation. For example, ASIC estimated that the average amount of superannuation owed by all companies entering administration is between \$126 million and \$208 million per year.⁴² Additionally, in 2004-05, ATO wrote off \$55 million in superannuation guarantee charge debt (which consists of the shortfall in superannuation not paid, interest and an administration charge).⁴³

It was determined that these estimates could not be included in the model as it would require estimating the proportion of this total cost that is due to phoenix activity.

⁴² The ASIC External Administrators, Schedule B statistics 1 July 2004 – 30 June 2007 report

⁴³ Provided in consultations with GEERS

Number of phoenix operators

A key challenge in quantifying phoenix activity is estimating the number of companies engaging in the activity. In 2001/02, 1.6% of complaints (194 complaints) that ASIC received related to phoenix activity and this was used as a lower bound estimate of the number of cases of phoenix activity per year.

In 2009, the ATO finalised 124 phoenix cases and derived \$83.3 million as a result.⁴⁴ Of these 124 cases, 75 were finalised via field audits or reviews, with the balance being a mixture of other compliance strategies. Out of these 75 cases, in 55 cases money was raised.⁴⁵ Therefore, the average liability raised by the ATO per productive case was \$1.5 million. In the same year the ATO estimated that the current cases of suspected phoenix activity they were monitoring pose a risk to government revenue of \$600 million per annum.⁴⁶ Using the average tax liability, it can be extrapolated that the ATO were monitoring approximately 400 cases of phoenix activity. This was also used to test the sensitivity of results.

Table 14: Sensitivity testing of number of phoenix operators

Item for testing	Parameter	Impact on employees
Number of complaints of phoenix companies to ASIC	194	\$16,085,782
Number of suspected phoenix companies ATO monitoring	400	\$33,166,560

4.3 Impact on businesses

As previously described, in 1996 the Australian Securities Commission (ASC), published a report on phoenix activity titled *Phoenix Activities and Insolvent Trading*. In the report, it was estimated that phoenix activity cost businesses \$0.67 to \$1.3 billion per year or 0.13% to 0.28% of GDP.⁴⁷ This estimate was based on a four step method drawing on ABS data and data gathered in a telephone survey that was conducted for the project.

Indexed to 2009/10, the impact of phoenix activity on businesses is estimated to be \$0.99 to \$1.93 billion per annum. It is recognised that the impact of phoenix activity on businesses is likely to have increased since 1996 due to the rise of phoenix activity and the spread of phoenix activity to higher turnover companies.

4.4 Impact on government revenue

As well as impacting employees and businesses, phoenix activity impacts on government through unpaid tax and GEERS payments made to the employees of phoenix companies.

As already noted, the ATO estimated that the cases of phoenix activity they were monitoring in 2009 posed a risk to government revenue of \$600 million.

⁴⁴ Provided in consultations with the ATO.

⁴⁵ *Ibid.*

⁴⁶ Treasury 2009, *Action against fraudulent phoenix activity: proposals paper*, November 2009, p. 5.

⁴⁷ Barlow, Darren 1996. *Phoenix Activities and Insolvent Trading*, p 149.

In 2009/10, \$154 million in GEERS payments were made. In the risk profiling, a lower bound estimate of employees impacted by phoenix activity of 0.5% was used and an upper bound estimate of 6.85%. These parameters were applied to the employees receiving GEERS to calculate a lower and upper bound estimate of the impact on GEERS payments.⁴⁸

The upper bound is based on the number of cases under GEERS which involved the transfer of a business in 2009/10. Of the 2,131 GEERS cases received in 2009/10, approximately 146 or 6.85% of cases showed some evidence of the transfer of a business.⁴⁹ As this evidence is a pre-requisite for phoenix activity, GEERS data suggests that the upper bound estimate for the percentage of GEERS cases impacted by phoenix activity would be at most 6.85%.

Table 15: Impact on government revenue

	Lower bound	Upper bound
Tax revenue ⁵⁰	\$600,000,000 ¹	\$600,000,000 ¹
GEERS payments ²	\$770,293	\$10,553,018
Total impact on government revenue	\$600,770,293	\$610,553,018

Note 1:

As the estimate of the impact of taxation revenue is based on ATO data, it was considered more robust to use the \$600 million estimate in both the lower bound and upper bound models.

Note 2:

The lower bound impact on GEERS payments was calculated assuming that 0.5% of total GEERS payments (\$154,058,670) in 2009/10 were made to former employees of phoenix companies. The upper bound impact on GEERS payments was calculated assuming that 6.85% of total GEERS payments (\$154,058,670) in 2009/10 were made to former employees of phoenix companies. The upper bound represents the proportion of GEERS payments that went to businesses where there was evidence that a transfer of a business has occurred.

4.5 Other impacts

It is recognised that there are a range of impacts of phoenix activity that have not been included in this quantification. These impacts have not been included because the existing data does not allow for a robust quantification, even if reasonable assumptions are made to fill data gaps.

The exclusion of these impacts from quantification mean that the true impact of phoenix activity may be greater than is suggested by the estimate of this project.

⁴⁸ Department of Finance, 2011. *Regulation Impact Statement for Taxation Changes to Address Fraudulent Phoenix Activity*, p2

⁴⁹ Provided in consultations with GEERS

⁵⁰ Treasury 2009, *Action against fraudulent phoenix activity: proposals paper*, November 2009, p. iv.

These impacts, which are detailed below, include the impacts of phoenix activity on employees (such as superannuation), businesses (such as unfair advantage) and government (such as monitoring and enforcement costs) and the environment (such as avoidance of regulatory obligations).

Employees

Employees experience a range of impacts other than lost wages, entitlements and superannuation from phoenix activity. First, if employees are not rehired by the new company, they will often experience periods of unemployment. These periods of unemployment can have significant impacts such as a disintegration of skills.

Employees experience a range of impacts from phoenix activity.

Even if an employee is re-hired by the phoenixed company, they will often have a period of weeks or months where they are unemployed. Union stakeholders have indicated that during this period, the phoenix operator will often reassure the employee that they will be able to start work very soon. Therefore, employees will not claim unemployment and often experience financial distress before they are re-hired by the phoenixed company.

The impact of phoenix activity on employees' superannuation was included as a sensitivity test as the GEERS data does not include superannuation. However, it is important to note that the impact of phoenix activity on superannuation can have significant ramifications. In the paper *Combating the Phoenix Phenomenon: An Analysis of International Approaches*, the extent of the impact is described:

*“it is possible for an employee to work in the same factory, with the same machinery, for the same management, in ostensibly the same business, over the course of the employee’s working life, with no immediate realisation that the business has been perpetually phoenixed... Essentially the employee appears to be in continuous employment. However the employee’s superannuation benefits will be significantly reduced as a result.”*⁵¹

Many employees of phoenix companies would not have worked for the company long enough to have accrued long services leave (as often the company will not have been operating for that long). However, when the business is liquidated and if the employee is re-hired by the new company, the new entity will not recognise this long service leave.

Businesses

One of the impacts of phoenix activity that has not been quantified is the unfair advantage phoenix companies receive.

One of the impacts of phoenix activity that has not been quantified is the unfair advantage phoenix companies receive. By knowingly avoiding debts to other businesses, tax debt and employee entitlements, phoenix businesses are able to offer lower prices than their competitors. Stakeholders indicated that this is a significant problem in the cleaning industry, with operators often engaging in phoenix activity in order to 'undercut' their competitors. There have not been any prior attempts to quantify the impact of the unfair advantage that phoenix operators receive.

Government

There are a range of impacts on government that have not been quantified. The FWO, ATO and ASIC all spend resources on monitoring and investigating phoenix activity. It

⁵¹ Roach, Murray. 2010. 'Combating the Phoenix Phenomenon: An Analysis of International Approaches'. eJournal of Tax Research, vol 8, no 2, p90-127

is recognised that this has benefits for government revenue as it often leads to the recovery of outstanding tax debts.

The government also bears some of the cost of periods of unemployment through unemployment payments made.

5 Suggested actions to address phoenix activity

Over the past decade a number of studies and reports have explored options for mitigating phoenix activity. A range of actions, including those that have been recommended by previous work on phoenix activity, were considered during this project and tested with stakeholders.

The suggested actions were selected based on their proportionality to the scale of the problem, feedback from government and non-government stakeholders and their potential to successfully mitigate phoenix activity.

5.1 Previous recommendations for addressing phoenix activities

Over the past two decades there have been a significant range of proposals for addressing phoenix activity. Most of these options have focused on legislative change and reform.

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In the late 1990s Minister Reith, then Minister for Employment, Workplace Relations and Small Business, proposed the introduction of a national insurance scheme to protect employee entitlements.⁵² It was argued that the scheme could be funded by a levy on business, with the levy amount dependent on the businesses wages costs. Companies would be excluded if they provided evidence that they were protecting employee entitlements.

An insurance scheme again received attention in 2004 when the Stockdale Report recommended that “the Government explore the various measures proposed for safeguarding employee entitlements such as insurance schemes or trust funds, giving particular attention to the costs and benefits involved in the schemes”.⁵³ However, the Stockdale Report also warned “the proposals for the establishment of insurance schemes or trust funds are a major departure from the current system and would require thorough examination and extensive consultation before even a preliminary model could be produced”.⁵⁴

In 2004 the Parliamentary Joint Committee on Corporations and Financial Services conducted a *Stocktake of Corporate Insolvency Laws* which explored whether special

52 O'Neill, Steve, 2011. *Meeting employee entitlements in the event of employer insolvency*, Australian Parliamentary Library. Available at: <http://www.aph.gov.au/library/pubs/bn/eco/EmployeeEntitlements.htm>

53 Stockdale Report 2004, recommendation 44.

54 Stockdale Report 2004, recommendation 44.

provisions should be made in insolvency laws regarding phoenix activity.⁵⁵ The Committee recommendations included:

- amendments be made to Corporations Law so that Courts or ASIC can disqualify directors if the person is, or has been, a director of a company which has failed and the person acted in a way that made them unfit to manage a company
- the Government consider creating an injunction process to enable courts to freeze assets of a director or manager where, prima facie, the corporation has a just claim
- that ASIC consider establishing a hotline and strategically locate employees for the purpose of facilitating possible early detection and/or prevention of phoenix activity.

In the paper *Action against Fraudulent Phoenix Activity: Proposals Paper*, Treasury made a range of recommendations to amend director's liability provisions and taxation law.⁵⁶ Recommendations made by the proposal paper included:

- removing the ability of directors engaged in fraudulent phoenix activity to avoid personal liability for PAYG(W) liabilities by placing the company into administration or liquidating the company
- ensuring the promoter penalty regime is able to target those individuals promoting fraudulent phoenix activity
- providing the Commission of Taxation with the discretion to require a company to provide an appropriate bond (supported by sufficient penalties) where it is reasonable to expect that the company would be unable to meet its tax obligations and/or engage in fraudulent phoenix activity
- making directors personally liable for the debts of a liquidated company in circumstances where a 'new' company adopts the same or similar names as its previous incarnation
- adopting the doctrine of inadequate capitalisation and allow the corporate veil to be lifted where a company sets up a subsidiary with insufficient capital to meet the debts that it could be reasonably expected to incur.

Some of these options, such as the denial of PAYG(W) credits for non-remittal of payments and the expansion of the director penalty regime to superannuation payments, have subsequently been adopted by government (but are yet to pass Parliament).

5.1.1 Cole Inquiry recommendation

In 2003 the Cole Inquiry made a range of recommendations to reform the building and construction industry. The Inquiry found that there was significant incidence of phoenix activity in the building and construction industry and made a series of recommendations to mitigate this. The below table summarised the recommendations of the Cole Inquiry that related to phoenix activity and the status of their implementation. Government agencies indicated, as the below table shows, that a

⁵⁵ Parliamentary Joint Committee on Corporations and Financial Services 2004, *Corporate Insolvency Laws: a Stocktake*. Available at: http://www.aph.gov.au/senate/committee/corporations_ctte/completed_inquiries/2002-04/ail/report/ail.pdf

⁵⁶ Treasury 2009, *Action against Fraudulent Phoenix Activity: Proposals Paper*, p vi-vii

significant amount of the recommendations of the Cole Inquiry that related to phoenix activity have been implemented.

Table 16: Stocktake of Cole Inquiry recommendations

Phoenix activity recommendations		Status of implementation
Recommendation 101	The Commonwealth encourage the States and Territories to consider the adoption of the provisions contained in s16LA of the Pay-Roll Tax Act 1971 (NSW) to address phoenix company activities in the building and construction industry. These provisions make all members of a group jointly liable for the payroll tax debts of other group members.	Not implemented. Due to the significant changes to corporation law and insolvency law that this change would have involved it was considered not warranted. ⁵⁷
Recommendation 102	The Commonwealth discuss with the States and Territories appropriate methods of permitting their revenue authorities to share information relevant to the detection of payroll tax evasion in the building and construction industry where this does not already occur.	Implemented A working party was established by the Government comprising all the relevant parties. ⁵⁸ Additionally, the ATO and Office of State Revenue have and continue to hold regular meetings.
Recommendation 104	The Commonwealth establish guidelines on the separate responsibilities of the major government agencies, particularly the Australian Securities and Investments Commission and the Australian Taxation Office, in combating fraudulent phoenix company activity in the building and construction industry. The agencies given major responsibilities should be given appropriate resources to combat fraudulent phoenix company activity in the building and construction industry.	Implemented The ATO and ASIC prepared and signed a MOU to formalise the relationship between the agencies. ⁵⁹
Recommendation 105	The Commonwealth convene a working party consisting of representatives of the Australian Taxation Office, the Australian Securities and Investments Commission and State and Territory revenue authorities, together with the Privacy Commissioner, to address the issue of appropriate amendments to relevant legislation to permit the exchange of information which may assist in the detection of fraudulent phoenix company activity in the building and construction industry.	Implemented. The Government formed a working party, consisting of the relevant parties, to implement the recommendation. ⁶⁰
Recommendation 106	The measures developed by the Australian Securities and Investments Commission to check all new company officers against the National Personal Insolvency Index and to check that current directors have not been	Implemented. In 2004 ASIC, in cooperation with the Insolvency and Trustee Service Australia, commenced a [program to identify persons disqualified from

⁵⁷ Table of the Government's Response to the 212 recommendations of the Royal Commission into the Building and Construction Industry. Provided to PwC by ATO (obtained from the Workplace Relations website on 10 November, 2003)

⁵⁸ *Ibid.*

⁵⁹ *Ibid.*

⁶⁰ *Ibid.*

Phoenix activity recommendations		Status of implementation
	declared bankrupt appear to address this issue and should be implemented without further delay.	managing a company. ⁶¹
Recommendation 107	The Australian Securities and Investments Commission ensure that its procedures identify when companies in the building and construction industry are left without a director following the bankruptcy of a serving director.	
Recommendation 108	The Commonwealth, after consultation with the Australian Securities and Investments Commission, consider the need for an increase in the maximum penalties provided in the <i>Corporations Act 2001 (C'wth)</i> for offences that may be associated with fraudulent phoenix company activity.	<p>Implemented.</p> <p>As part of the CLERP 9 –legislation (released on 8 October 2003 for public consultation), the Government amended the <i>Corporations Act 2001</i> so the maximum disqualification periods of persons from managing corporations for insolvency and non-payment of debts will be increased from 10 to 20 years.</p> <p>Further, other amendments allowed ASIC to apply to a Court to have an automatic 5 year disqualification order extended by up to a further 15 years. In line with the CLERP 9 issues paper recommendation, the Government reviewed the penalties associated with phoenix company activity as part of a wider review of all the <i>Corporations Act 2001</i> civil and criminal penalty provisions.</p>
Recommendation 109	The Commonwealth, after consultation with the Australian Securities and Investments Commission, consider the need for an amendment to s206F of the <i>Corporations Act 2001 (C'wth)</i> to provide for the power of disqualification contained therein to be exercisable in appropriate circumstances after a person on one occasion has been an officer of a corporation that has been wound up and been the subject of a liquidator's report under s533(1) of the <i>Corporations Act 2001 (C'wth)</i> .	<p>Not implemented.</p> <p>The Government considered the change not warranted as it would “reduce the criteria to one corporate collapse, and deliberate phoenix activity typically involves two or more such failures”.⁶²</p>
Taxation recommendations relevant to phoenix activity		
Recommendation 124	The Commonwealth consider providing increased funding to the Australian Taxation Office for additional resources to be utilised for compliance activities in the building and construction industry.	<p>Implemented.</p> <p>The ATO now receives funding for a team dedicated to monitoring phoenix activity.</p>

⁶¹ ASIC, 2011. *Data matching program between ASIC and Insolvency and Trustee Service Australia*. Available at: [http://www.asic.gov.au/asic/asic.nsf/byheadline/New+data+matching+program+between+ASIC+and+Insolvency+and+Trustee+Service+Australia+\(ITSA\)++?openDocument](http://www.asic.gov.au/asic/asic.nsf/byheadline/New+data+matching+program+between+ASIC+and+Insolvency+and+Trustee+Service+Australia+(ITSA)++?openDocument)

⁶² *Table of the Government's Response to the 212 recommendations of the Royal Commission into the Building and Construction Industry*. Provided to PwC by ATO (obtained from the Workplace Relations website on 10 November, 2003)

Phoenix activity recommendations		Status of implementation
Recommendation 125	The Australian Taxation Office consider dedicating additional resources to audit, monitor and review compliance by the building and construction industry with the Alienation of Personal Services Income legislation.	Implemented, The ATO now receives funding for a team dedicated to monitoring phoenix activity.
Recommendation 126	The Australian Taxation Office review the impact of the Alienation of Personal Services Income legislation for the year ended 30 June 2003 (following 12 months of operation within the building and construction industry) and critically examine the results of the review to determine the effectiveness of the legislation in ensuring contractors in the building and construction industry comply with their taxation obligations.	Implemented. The Government undertook a review after the end of the 2003/04 financial year. ⁶³
Recommendation 130	The Commonwealth and the Australian Taxation Office consider, as a matter of priority, the utility for the building and construction industry of an amendment to the <i>Income Tax Assessment Act 1936 (C'wth)</i> in the form of s16LA of the <i>Payroll Tax Act 1971 (NSW)</i> making all the members of a group jointly and severally liable for the taxation debts of other group members.	Not implemented. The Government did not implement this recommendation as it was considered that there “insurmountable difficulties in the administration of the taxation system” and as such, the Government considered the change as being not necessary. ⁶⁴
Recommendation 131	The Commonwealth and the Australian Taxation Office consider, as a matter of priority, the utility for the building and construction industry of an amendment to s222AOB of the <i>Income Tax Assessment Act 1936 (C'wth)</i> to remove the right of a director of a phoenix company involved in fraudulent activity to avoid the consequences of a Director’s Penalty Notice by placing the company into voluntary administration or into liquidation.	Implemented. ⁶⁵
Recommendation 135	<p>A. The Australian Taxation Office establish a Building and Construction Industry Forum:</p> <ul style="list-style-type: none"> i. (to examine taxation issues of significance to the building and construction industry including phoenix company activity; and ii. to develop workable solutions to the issues and problems identified, including where necessary proposals for taxation policy changes and legislative amendments. <p>B. Membership of the Building and Construction Industry Forum should include representatives of all major industry participants including unions and employer organisations.</p>	The Building and Construction Industry Forums was established and still meets.

⁶³ *Ibid.*

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*

5.2 Options discussed with stakeholders

A range of high-level options were tested with stakeholders. These included those outlined in Section 5.1 as well the options detailed below.

5.2.1 Cross agency options

As phoenix activity involves the avoidance of taxes, employee entitlements and other debts, there are three primary agencies that can detect and act on suspected phoenix activity, the ATO, ASIC and FWO.

As phoenix activity involves the avoidance of taxes, employee entitlements and other debts, there are three primary agencies that can detect and act on suspected phoenix activity, the ATO, ASIC and FWO.

There are a range of cross agency actions that could be taken to address phoenix activity. Stakeholders emphasised the importance of agencies working cooperatively to mitigate phoenix activity. It is recognised that there is already progress in this space with a MOU that related to information sharing in general signed between the ATO and ASIC and a cross agency forum on phoenix activity meeting regularly. It is recognised that these interagency efforts are in their preliminary stages and there is significant scope for further cooperation to achieve compliance outcomes.

Joint government education campaign and website

Stakeholders highlighted that there is limited awareness of the issue of phoenix activity in the community and how to identify it. To raise community awareness, an education campaign could be run which describes phoenix activity and how it can be identified. This campaign could particularly focus on:

- how businesses can identify if businesses they work with are engaging in phoenix activity
- how employees can identify if their employer is engaging in phoenix activity or if their former employer engaged in phoenix activity.

The campaign could be sponsored and supported by all relevant agencies. Collaboration with unions and employee groups could also assist in distributing material produced as a part of the campaign.

A central complaints phone line or website could also be established for members of the community to refer suspected incidents of phoenix activity to all three relevant agencies. However, this would be potentially costly and would require significant staffing. Additionally, this option could involve a significant degree of risk in that people who make complaints may have significant expectations regarding the subsequent action that will occur.

An alternative to a complaints line would be for the campaign website to provide information of the existing complaint mechanisms at each agency. For example, information could be provided on how to contact the FWO if a person suspects that phoenix activity has occurred.

Out of all the options, stakeholders were perhaps most positive about a joint government education campaign. Many stakeholders highlighted that involving the community, including businesses and employees, would be essential for mitigating phoenix activity.

Multiple stakeholders also commented that this option could be effective as a part of a broader publicised crack down on phoenix activity which was described as a 'shock and awe' strategy to 'maximise the heat on phoenix operators'.

Publication of list of repeat offenders

As a part of the joint education campaign option, or separate to the education campaign, a 'naming and shaming' approach could also be adopted. The ASIC maintains an online list of banned directors of companies. The website on phoenix activity could have a list of directors who had previously been banned or had findings against them for phoenix activity. Visitors to the website, many of whom would be employees, could then search for the name of their employer or prospective employers. Additionally, businesses could search the database before entering contracts with other businesses.

The publication of repeat offenders could be coupled with an education campaign. This two pronged strategy would seek to make it very difficult for repeat offenders to continue to operate businesses. Many stakeholders were enthusiastic about this option, particularly if it was combined with an education campaign.

It is recognised that there may be potential legal and privacy issues with the publication of a list of repeat offenders. For this reason, stakeholders indicated that the publication of such a list would need to be subject to investigation prior to implementation.

Statutory task force on phoenix activity

A long term option could be the establishment of a statutory task force on phoenix activity. This could be supported by all the relevant agencies and facilitate ongoing data sharing, cooperative campaign work and integrated monitoring (which could occur through a 'watch list' targeting repeat offenders).

Multiple stakeholders noted that statutory task forces have significant reporting requirements and argued that the benefits of a statutory task force would likely not be worth the significant administrative costs. Some stakeholders expressed a preference for MOUs and a continuation of the current forum arrangement.

Pooling of assets and liabilities

In 2004 the Corporations and Markets Advisory Committee proposed that assets and liabilities of companies be aggregated and creditors paid from a common pool which is commonly referred to as 'pooling of assets'.⁶⁶ In 2007 'pooling' was introduced for cases where all companies in a group are insolvent. Stakeholders highlighted that this option received significant attention in 2007-08 and therefore, there is a significant body of work that exists examining the pooling of assets and liabilities. It was also argued by many stakeholders that such an option has significant implications for corporations law.

⁶⁶ Anderson, Helen. 2011. *Phoenix Activity and the Recovery of Unpaid Employee Entitlements – Ten Years On*, p 19.

5.2.2 Fair Work Ombudsman options

The following are a range of potential options for the FWO to mitigate phoenix activity. These options recognise that the FWO does not currently have the power to investigate phoenix activities and there are significant limitations on the options available to the FWO once a company enters liquidation.

Specialist phoenix activity inspectors

Like the ATO, the FWO could have a team of inspectors who specialise in investigating suspected phoenix activity. This option would require significant resources and also require reform of the *Fair Work Act 2009* to enable inspectors to investigate such issues.

Perhaps the most significant advantage to this option is that it could facilitate ongoing monitoring of repeat offenders. There was not significant support for this option amongst stakeholders as it was felt that the additional benefits would not justify the significant costs.

The FWO have indicated that rather than training specific specialist phoenix activity inspectors, more informal options such as cross-agency training to develop 'subject matter experts' in phoenix activity would be preferred.

Database of directors and office holders

The FWO could also establish a database which could store information on directors and office holders' history of non-compliance. This could facilitate better monitoring of compliance, better data collection and assist in investigations.

There was significant support amongst stakeholders for options which seek to improve monitoring and data collection of phoenix activity.

Possible proceeding under the Fair Work Act

As part of this project, expert input was provided by employment law specialists Herbert Geer. Herbert Geer raised the possibility that the FWO could recover amounts lost by individual employees of a company by suing directors, other managers or agents of the company after the company has become insolvent. Currently, FWO cannot take action against companies without leave from the court (under Section 440D of the Corporations Act) and even then, there is the possibility that there is nothing to recover.

Targeted education and media campaign

As well as a whole of government campaign, or as an alternative to a whole of government campaign, the FWO could run a targeted education and media campaign. The campaign could be run in collaboration with stakeholders and have a specific focus on creating greater awareness amongst employees of the signs of phoenix activities. Stakeholders expressed a preference for a cross agency education campaign due to the additional funding and therefore, impact it would have.

5.2.3 Legislative options

There are a range of legislative options for addressing phoenix activity and the following legislative options were explored with stakeholders.

Garnishee Orders

The ATO has the power to issue garnishee orders which allow recovery of debts from a person's bank account, wage or from people who owe the debtor money. Legislative change could be introduced so that the FWO could garnish unpaid entitlements from bank accounts, wages and debtors. Stakeholders emphasised that this would be a significant expansion of the FWOs role.

Dual appointment of FWO Inspectors

An additional legislative option would be for FWO Inspectors to be appointed under the Tax Act and the Corporations Act giving them greater powers in their investigations. Stakeholders had significant reservations about the practicalities, viability and effectiveness of such an option.

Joint employment provisions

One option that was raised in consultation with stakeholders was the introduction of joint employment provisions, whereby both the employing entity and the entity that receives the labour are liable for employee expenses. Though some stakeholders were broadly supportive of such measures, others highlighted that this option would have significant implications for corporations law and sub-contract arrangements in Australia.

5.3 Suggested actions for addressing phoenix activity

The following actions are suggested for addressing phoenix activity. Those that have been suggested are the actions that:

- received significant support in stakeholder consultation
- are proportional to the identified scale of the problem of phoenix activity
- on the information available, are most likely to be effective in addressing phoenix activity.

5.3.1 Cross agency actions

As already described, the ASIC, ATO and FWO all have responsibilities in investigating and monitoring elements of phoenix activity. This means a whole of government approach is necessary to ensure coordination and information sharing between the relevant agencies. Progress has been made in this area with ATO and ASIC having general information sharing arrangements and the FWO establishing a similar arrangement with the ASIC.

However, in suggesting cross agency actions it is essential that:

- the different responsibilities of the agencies are recognised
- that the different levels of resources available to combat phoenix activity of each agency are recognised.

Suggested action 2

A cross-agency education campaign should be initiated to educate the community about the indicators of phoenix activity.

The government agencies and non-government stakeholders were broadly supportive of a cross agency education campaign. Many stakeholders commented that there is limited awareness in the community on what phoenix activity is and how it can be identified. By educating the community on how to identify phoenix activity, many stakeholders indicated that there could be a resultant increase in the cases of phoenix activity reported to the FWO, ATO and ASIC. There are a range of ways that such an education campaign could be implemented. Possible approaches are outlined below.

1 Education campaign

An education campaign could be designed to target workers and businesses and inform them of:

- what phoenix activity is
- how it can be detected
- what action they can take if they suspect phoenix activity has occurred.

It could be publicised through television advertisements (if there was sufficient funding), bus stop advertisements, publications (such as flyers) distributed by unions and industry groups and/or advertisements in trade publications.

2 Education campaign and website

The education campaign could also be accompanied by a website with additional information on phoenix activity. The cross-agency website could have links to complaint mechanisms.

The website could also have a dedicated section for employees who suspect their employer or former employer has engaged in phoenix activity and an additional section for businesses that suspect that businesses that they have worked with (either as clients of or as suppliers to) have engaged in phoenix activity. These sections could detail common signs or signals.

3 Education campaign, website and hotline

The education campaign and website could be supplemented by a dedicated phoenix activity hotline which people could report suspected phoenix activity to. The hotline could be a cross agency initiative or be managed and run by one agency. Regardless of who was responsible for the hotline, there would need to be clear guidelines on how complaints were referred to the relevant agencies.

Though a hotline could assist in the detection of phoenix activity, it would likely raise the expectations of complainants regarding the action that would be taken against the suspected phoenix operator. If such an option were introduced, expectations would have to be carefully managed.

Additionally, a hotline may be very costly to introduce and operate. The associated costs of the hotline may not

Suggested actions to address phoenix activity

be justified by the anticipated benefits. Prior to the introduction of a hotline, costing would have to be conducted and an assessment made of the potential benefits.

It is suggested that an education campaign and website be implemented by ASIC, ATO and FWO.

Summary of suggested action: Cross agency education campaign

Agency/stakeholder involvement

ASIC, ATO and FWO with involvement from unions and employer groups

Legislative change requirements

N/A: non – regulatory option

Suggested action 3

Agencies should investigate publishing a register of repeat offenders.

Stakeholders noted that for many phoenix operators, it is relatively easy to continue operating their businesses in different forms without being detected. It was highlighted that in the cleaning industry, the private security industry and textiles and clothing manufacturing phoenix operators will often liquidate multiple companies without being detected. In order to make it difficult for phoenix operators and disqualified directors to continue operating businesses, a list of repeat phoenix operators could be published.

It is noted that ASIC already maintains a list of banned directors on their website. This approach would seek to complement this and build on this.

It is also noted that clear legal guidance would be required as to whether the agencies can name banned directors of failed companies that are suspected to have been involved in phoenix activity. Additionally, agencies such as ASIC and ATO, may not be able to participate in a register of repeat offenders. For example, the ATO has indicated that their secrecy and privacy laws operate to generally prohibit the Tax Commissioner from publicly disclosing the name of a person or entity that has been audited or investigated, including those confirmed as being involved in fraudulent phoenix activity. An exception to this rule is where a person has been prosecuted in a court of law.

It may be necessary to obtain statutory protection from defamation or breach of privacy proceedings by the relevant directors/managers.

Agencies would need to consider the likelihood of potential litigations or court actions due to the information being public.

Finally, there may be a range of practical difficulties and significant costs in implementing a register of repeat offenders in terms of keeping the website updated.

Despite these potential barriers, it was decided that a register of repeat offenders was worthy of consideration and investigation by agencies due to the potential to apply pressure to repeat offenders and make it difficult for them to operate businesses.

There are a range of ways that this suggested action could be implemented, these are described below.

Suggested actions to address phoenix activity

1 Links to banned directors on phoenix activity education campaign website	If the website was adopted as part of the education campaign, there could be links to ASIC's list of disqualified directors so that employees or businesses can check if the director of the company or any persons associated with the company have been banned as directors.
2 Database on the phoenix activity education campaign website	A second, higher cost option, would be to have a separate database of banned directors on the education campaign website. It is envisioned that this database could be searched by director name (including last name for cases where family members may have been former directors), registered business address, telephone number and business name. This would be different from the ASIC website as the ASIC database can only be searched by director name.
3 Database on the phoenix activity education campaign website and 'warnings' by industry	Certain industries have a very high concentration of phoenix activity, such as the cleaning industry and the private security industry. As well as the database on the website, there could be a page of 'warnings' by industry. For example, a page on the website could have a list of directors and companies in the private security industry that are serial phoenix operators. There could also be a mailing list by industry that people can sign up to and receive email alerts of newly banned directors in the industry. For example, businesses that employ cleaning subcontractors could sign up for alerts so they are aware of any phoenix operators in the industry.

Summary of suggested action: 'Naming and shaming' approach

Agency/stakeholder involvement	ASIC, ATO and FWO
Legislative change requirements	N/A: non – regulatory option

Suggested action 4

Memorandums of Understanding (MOUs) should be signed between the FWO and ASIC and FWO and ATO that formalise the current cooperative working arrangements.

Currently, the ATO and ASIC have a Memorandum of Understanding (MOU). A MOU sets out a framework for cooperation between two agencies and commonly involves the sharing of otherwise confidential information.

With multiple agencies involved in phoenix activity, stakeholders emphasised that the effective mitigation of phoenix activity must involve information sharing between agencies. It was also highlighted that if it was known that all agencies were monitoring suspected phoenix operators, this could 'maximise the heat' on the phoenix operators and mitigate the perception that it is relatively easy to engage in phoenix activity without detection.

It is noted that it is not possible to have a MOU between three organisations. This means that ATO and ASIC, ASIC and FWO and FWO and ATO must each have separate MOUs. Having MOUs between all the relevant agencies would allow each agency to share information regarding the suspected cases of phoenix activity that they are monitoring and expand on the existing cross agency efforts.

In consultations with stakeholders the option of establishing a statutory taskforce on phoenix activity was raised. However, some stakeholders felt that the benefits of a statutory task force (in terms of greater information sharing and possible additional funding), would not outweigh the significant reporting requirements. It is understood that a statutory task force on phoenix activity is being considered, however the administrative costs will need to be taken into account.

Summary of suggested action: MOUs between agencies

Agency/stakeholder involvement	ASIC, ATO and FWO
Legislative change requirements	N/A: non – regulatory option

Suggested action 5

Cross agency initiatives to improve data collection on phoenix activity should be examined.

There is currently limited strategic data collection by government agencies on the incidences of phoenix activity. There would be a range of benefits to improving data collection:

- phoenix activity could be more robustly quantified and a better picture of the scale of the problem established
- trends in phoenix activity could be tracked which could result in more effective targeting of monitoring and compliance activities.

Better data collection would be most effective if it was implemented across government agencies. It is recognised that each agency has privacy provisions that they must abide by. Therefore, data sharing across agencies could be limited to 'macro' data.

Additionally, better data collection could be achieved through MOUs between agencies which allow the sharing of information. The below suggested actions are intended to complement the signing of MOUs.

There are three alternative approaches that have been identified for improving data collection.

1 Existing data sharing and collection	Currently, each agency engages in differing levels of data collection. Agencies could, on an annual basis, share the information that they collect. It is noted that there may be a limit to the effectiveness of this option as different agencies collect different information. Therefore, calibration of each agency's data may be problematic.
2 Uniform database and de-identified data sharing	<p>An alternative option would be for each agency to have a database through which cases of suspected phoenix activity can be tracked. When a case of suspected phoenix activity is encountered, the following details could be entered into the database:</p> <ul style="list-style-type: none">• if the director (or family members) has been involved in any previous liquidations• the name of the director (and any known associates)• registered name of the business• the telephone number (including mobile number)• the registered business address• the industry of the business. <p>The de-identification of data may be necessary to adhere to each agency's privacy requirements. Therefore, de-identified 'macro' data (such as the number of suspected incidents by industry and if the director had been involved in any previous liquidations) could then be collated and shared on an annual basis. It is recognised that multiple agencies may encounter a suspected case and therefore, there may be double-counting.</p>
3 Uniform database and full data sharing	If MOUs could allow for it, the data sharing could be of the full information collected, including name of the

Suggested actions to address phoenix activity

director and name of the business. This would ensure that double counting does not occur and allow for agencies to focus on monitoring repeat offenders.

Summary of suggested action: Cross-agency data sharing

Agency/stakeholder involvement

ASIC, ATO and FWO

Legislative change requirements

N/A: non – regulatory option

Suggested action 6

That agencies consider conducting joint phoenix specialist training.

In order to improve the monitoring and compliance activities of all agencies, joint training of phoenix ‘specialists’ or experts could be conducted. It is envisioned that the training could be conducted by experts from the ATO, ASIC and FWO.

It is envisioned that the training would have a range of benefits including:

- developing subject matter experts across the relevant agencies
- encouraging information sharing of the latest trends in phoenix activity
- encouraging collaboration and cooperation between the relevant agencies.

1. Annual conference

The training could be conducted once per year at an annual conference. Conference participants would include employees of each agencies that work in the area of phoenix activity. For example, ATO phoenix activity inspectors and FWO inspectors could attend.

2. Ongoing training course

An alternative, more costly option, would be for the joint training to be an ongoing course. Sessions or trainings could be spread over the year in order to develop the knowledge of phoenix activity specialist.

Summary of suggested action: Joint training of phoenix specialists

Agency/stakeholder involvement

FWO, ASIC and ATO

Legislative change requirements

N/A: non – regulatory option

5.3.2 Fair Work Ombudsman options

Suggested action 7

The FWO should investigate possible proceedings under the *Fair Work Act* to recover unpaid entitlements from directors of phoenix companies.

Analysis conducted by Herbert Geer suggests that it may be possible for the FWO to recover amounts lost by individual employees of a company by suing directors, other managers or agents of the company after the company has become insolvent. The frustration for FWO in the past has been that it has found that it could not sue the company without leave of the court (for example, section 440D of the Corporations Act) and even then, there is often nothing to recover.

It is recognised that in the past the FWO has resisted using this provision to maintain the corporate veil. However, it has been recommended that possible proceedings under the *Fair Work Act* be investigated though it is recognised that consideration will have to be given to a range of complex issues before proceedings were undertaken.

Section 550(1) of the *Fair Work Act* provides that “a person who is involved in a contravention of a civil remedy provision is taken to have contravened that provision.”

Section 550(2) of the *Fair Work Act* provides that a person will be taken to be “involved in” a contravention if, and only if, the person:

- a) has aided, abetted, counselled or procured the contravention
- b) has induced the contravention, whether by threats or promises or otherwise
- c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in or party to the contravention
- d) has conspired with others to effect the contravention.

Under section 545(1) of the *Fair Work Act*, the Federal Court or Federal Magistrates Court may make any order the Court considers appropriate if the Court is satisfied that a person has contravened, or proposes to contravene, a civil remedy provision. Section 545(2)(b) of the *Fair Work Act* provides that without limiting section 545(1), orders the Federal Court or Federal Magistrates Court may include an order awarding compensation for loss that a person has suffered because of the contravention.

Section 50 of the *Fair Work Act*, a civil remedy provision, provides by way of example “a person must not contravene a term of an enterprise agreement.”

A breach of section 50 will arise where a company has underpaid a person who has an entitlement to a minimum wage under an enterprise agreement. If a director or other manager of a company aids and abets the underpayment of employee entitlements under an enterprise agreement then they may be said to also be involved in the contravention in accordance with section 550. If the company subsequently becomes insolvent and recovery of the underpayment is not possible against the company then recovery may be possible against the director or manager.

Under section 550(2), merely being a director or manager of itself will not expose that person to an action for recovery. They must have been actively involved in aiding and abetting the contravention. Perhaps the manager has recruited someone on below agreement wages and then promised them the wages would be made up at a later time when they knew that the company was already in financial difficulty. There will obviously be an evidentiary burden to overcome in proving that such an individual aided or abetted this breach of the enterprise agreement.

Suggested actions to address phoenix activity

Presuming this could be overcome, it could be shown that the individual has been complicit in a breach of section 50 and is effectively jointly liable for the contravention by virtue of section 550. They could then be required by the court to compensate the underpaid employees under section 545(2)(b). The Court also has the power under section 545(2)(a) to grant an injunction to stop or remedy the effects of a contravention. Consequently the FWO could apply for an injunction to stop the relevant persons from disposing of assets until the employees are compensated.

This presumes that such a manager will have the financial resources to satisfy such an order but there doesn't seem to be any reason why this approach could not be adopted where the relevant facts are made out.

It is recommended that the FWO further investigate commencing possible proceedings under the *Fair Work Act* of the type identified above.

Summary of suggested action: Further investigation of possible proceedings under the *Fair Work Act*

Agency/stakeholder involvement	FWO
Legislative change requirements	N/A: non – regulatory option

Suggested action 8

The FWO should implement a database for monitoring phoenix activity.

Across government there appears to be limited data capturing and collection on phoenix activity (as has already been described). In stakeholder consultations many expressed a desire for greater collection of data across all agencies. It was argued that greater data collection would have a range of benefits including those which were detailed in suggested action 5.

Within the FWO there was enthusiasm for the establishment of a database of suspected phoenix operators. Currently, the FWO does not keep consolidated records on cases of suspected phoenix activity. This means that the FWO cannot easily establish how many cases of suspected phoenix activity they have encountered or quantify trends in phoenix activity.

It is envisioned that when FWO investigators encounter suspected phoenix activity, details of the case would be entered into a database. Details entered into the database would include:

- name of director/s
- trading name of business
- registered address of business
- telephone number of business (including mobile phone number)
- industry of business.

It is important that the registered address and telephone number of the business are entered into the database. Often when a business engages in phoenix activity the trading name of the business (though not necessarily the operating name) and the director may change, but the premise and telephone number of the business will not change.

It is suggested that the database be able to be searched by any of the items above. This would allow 'mapping' or 'profiling' of suspected phoenix operators. For example, if a case of suspected phoenix activity was encountered, FWO investigators could search each of the items listed above to see if there are any previous businesses that may have a link to the suspected phoenix operator. The links between different companies that have been liquidated could then be 'mapped'.

It is recognised that such a database may be costly to establish and that it would take time to build up enough entries for the database to be of use. However, such a database would have significant benefits and allow the FWO to better track trends in phoenix activity and monitor offenders.

Summary of suggested action: FWO phoenix activity database

Agency/stakeholder involvement	FWO
Legislative change requirements	N/A: non – regulatory option

5.3.3 Legislative actions

In the consultations with stakeholders it was found that there was not broad support for significant legislative changes around phoenix activity. Many stakeholders expressed support for the legislative changes currently being introduced, however, had reservations about further legislative changes. Broadly stakeholders were concerned about:

- the effectiveness of potential legislative changes in mitigating phoenix activity
- potential issues of moral hazard as a result of legislative changes
- the implications for corporations law and entrepreneurship.

Stakeholders had reservations about adopting the New Zealand approach of defining phoenix activity in legislation and applying specific penalties to phoenix activity. Some stakeholders noted that defining phoenix activity in legislation could be beneficial if the definition was appropriate and it was accompanied by specific penalties for engaging in the activity. However, it was also noted that enshrining a narrow definition in legislation, such as that used in New Zealand, could create problems of moral hazard and potentially make it more difficult to address phoenix activity. In defining phoenix activity in legislation there could be problems of moral hazard in that phoenix operators would continue to engage in the activity but would not reuse their trading name in order to circumvent the laws.

Other options, such as joint employment provisions, also did not have significant support from stakeholders as it was argued that there would be significant implications for corporations law in Australia.

This being said, there was support for three legislative changes which it has been suggested should be investigated further:

- the FWO being granted garnishee powers or the ability for a person with standing to apply to a court for a garnishee order
- the incorporation of civil remedies into the *Fair Work Act 2009*
- the FWO being granted standing under the *Corporations Act* to recover entitlements for employees.

Suggested action 9

That there be consideration of granting the FWO the power to make garnishee orders or the ability for a person with standing to apply to a court for a garnishee order.

Under section 260-5 of Schedule 1 of the *Taxation Administration Act*, the ATO has the power to recover unpaid tax liabilities from third parties who owe money to or hold money for a tax debtor.⁶⁷ This power is commonly referred to as ‘garnishee power’ and involves the ATO requiring third parties (such as employers) to pay money owed (such as wages and salary) to a tax debtor directly to the ATO rather than to the tax debtor.

During consultations with stakeholders, it was proposed that the FWO could be empowered to make garnishee orders to recover unpaid employee entitlements from former directors. This presumes that the former director has first been found liable for the payment of such entitlements under relevant legislation. It was envisioned that garnishee orders that the FWO could make would be broadly similar to the ATO’s powers in that the outstanding amounts could be garnished from third parties owing money to the former director. This could include employers of the former director, banks that hold the former director’s savings or business associates who have outstanding debts to the former director.

This would require amendments to the *Fair Work Act 2009* to grant the FWO garnishee powers. It is recognised that such as legislative change would require the development of a Regulatory Impact Statement (RIS).

Many stakeholders, particularly union stakeholders, were very supportive of the FWO being granted garnishee powers. Though some stakeholders suggested a person with standing would benefit from the ability to apply to a court for a garnishee order. Other stakeholders noted this would involve a significant expansion of the FWO’s powers and expressed some reservations about such a change.

It should also be noted that the recent decision *FWO v Ramsey* involved a former director being required to use proceeds from the sale of property to pay unpaid employee entitlements (see the case study below). In the case the FWO utilised court procedures to obtain interlocutory orders against a company it was litigating to request information concerning the employment of staff. This was done with the intention of restraining the company from terminating their employees’ employment and to obtain monetary undertakings protecting employee entitlements in the situation where it was feared that the company would be sold or liquidated.

Case study: FWO v Ramsey

The case related to an abattoir in South Grafton whose directors had shut down and liquidated a number of service provider companies over a number of years. It was concluded that the group of companies were structured in order to avoid

⁶⁷ ATO, 2009. *ATO Receivables Policy: Chapter 12 Garnishee*. Available at: <http://law.ato.gov.au/pdf/rmp/rp0012v6.pdf>

payments ordered by a previous Court decision and to avoid direct legal responsibility for wages and entitlements.

The Deputy District Register “had no difficulty in concluding that the arrangements made for the inter-position of Tempus between Ramsey Food Processing and the employees who performed work in the operation of Ramsey Food Processing were irrelevant to their true employers. In the relevant period, the employer was, in my view, Ramsey Food Processing”. It was also concluded that Mr Ramsey was “the effective decision maker concerning all aspects” of the companies decision making, despite not holding the directorship of many of the companies.

Background

Throughout the operation of the abattoir a number of service providing companies were closed and employees transferred to other entities.

In 2002 the abattoir was temporarily closed and subsequently reopened. After it was reopened, 11 employees sought employment with the new company but were not granted it. A number of employees then took legal action and the court ordered the company to pay \$84,000 in outstanding employee entitlements.

Following the court decision, there were a series of transfers of employees to different service providers in order to avoid paying the outstanding entitlements. Workers at the abattoir were employed by a company named Tempus Holdings. Payments to employees would be made by Tempus. However, Ramsey Food Processing would transfer money to the Tempus bank account in order to meet these employee payments. The court concluded that this was an administrative arrangement and Ramsey Food Processing was effectively paying the employee wages.

In 2006 employees of the abattoir were informed that Tempus Holdings would no longer be supplying labour to the abattoir and that Paul Allen Contract Services would be willing to employ workers under the same terms as their existing employment. In 2008 the same was done and employees were transferred to Mortimer Administration Services.

Summary of suggested action: That there be consideration of granting the FWO the power to make garnishee orders, or the ability for a person with standing to apply to a court for a garnishee order.

Agency/stakeholder involvement	FWO
Legislative change requirements	Potential legislative amendments would need to be made to the <i>Fair Work Act 2009</i>

Suggested action 10

That there be consideration of amending the *Fair Work Act 2009* to include a civil remedy provision to prohibit an employer entering into a transaction with the intention of preventing its employees from recovering their employee entitlements.

There should be consideration of amending the *Fair Work Act 2009* to include a provision to prohibit an employer entering into a transaction with the intention of preventing its employees from recovering their employee entitlements.

It is recognised that it is difficult to prove to a criminal burden of proof (ie. beyond a reasonable doubt) that a person or a corporation has a specific intention to do something and it is likely that that would impose a significant evidentiary burden on the FWO or other persons with standing to do so. This results in a suboptimal level of deterrence as some phoenix operators are not able to be prosecuted. The FWO or other persons with standing could continue with the current provisions. Alternatively, a reverse onus of proof could be imposed in relation to such a provision. It may not be acceptable to impose a reverse onus of proof in relation to such a provision to require that if an employee missed out on their entitlements then it should be presumed that the employer had intended to deprive them of those entitlements. The reverse onus of proof does apply to a number of provisions in the *Fair Work Act 2009* but may not be considered to be reasonable in these circumstances.

A third option could be for a civil remedy provision to be imposed. This would mean that as well as a penalty of up to \$33,000 for contravening the section, under the *Fair Work Act 2009* the FWO or other persons with standing could apply for an order for compensation for the loss that a person (here the employees) has suffered because of the contravention (see section 545(2)).

It is recognised that there are a range of potential issues with such an approach that will need to be subject to further investigation. One potential issue with creating a new civil penalty provision is that it presumes that the target company is solvent and able to pay a fine or otherwise compensate the employees. Under the *Corporations Act* it is possible to reverse a transaction so that property is returned to a company for distribution to creditors in certain circumstances. To include such a provision in the *Fair Work Act 2009* may cause a conflict with the insolvency provisions of the *Corporations Act*.

Such a civil penalty provision could be directed at both a company and the directors and officers of a company to be more effective in supporting recovery of entitlements because even if the company is insolvent, if the officers and directors have assisted in attempting to deprive the employees of their entitlements (and cause the company to enter into such transactions) they might be required to compensate the employees out of their own assets.

If such a transaction has taken place and the relevant company is in liquidation, then the FWO or other persons with standing would need to seek leave of the Court to commence a proceeding against the company. However, courts tend to limit the number of proceedings they allow to preserve any assets for distribution to creditors.

Summary of suggested action: That there be consideration of amendments to the *Fair Work Act 2009* to include a civil remedy provision to prohibit an employer and its directors and officers entering into a transaction with the intention of preventing its employees from recovering their employee entitlements.

Agency/stakeholder involvement

FWO

Legislative change requirements

Legislative amendments would need to be made to the *Fair Work Act 2009*.

Suggested action 11

The FWO investigate being granted standing under the *Corporations Act* to sue on behalf of employees to recover entitlements where the employer has sought to deliberately prevent employees from recovering entitlements.

It is suggested that the FWO investigate being granted standing under the *Corporations Act* to sue on behalf of employees to recovery entitlements where the employer has sought to deliberately prevent employees from recovering entitlements. This would provide an additional avenue for the recovery of employee entitlements. However, it is recognised that there are a range of potential issues with such an approach that would need to be subject to investigation before the changes could be introduced.

First, it may be necessary for additional changes to be made to the *Corporations Act* to allow the FWO to require the production of documents etc. to effectively prosecute such claims. This could entail potential legislative complexities.

Furthermore, there may be potential issues with such an approach in that the FWO would be granted power to recover employee entitlements on behalf of individuals in circumstances where those individuals also have the right to sue for those amounts.

Consideration would also need to be given to the interaction between FWO and liquidators and ASIC who currently have such powers under the *Corporations Act* with regard to recovery of employee entitlements.

Summary of suggested action: FWO investigate being granted standing under the *Corporations Act* to sue on behalf of employees to recover entitlements.

Agency/stakeholder involvement

FWO

Legislative change requirements

Legislative amendments would need to be made to the *Corporations Act*.

Appendices

Appendix A Summary of stakeholder consultations

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Appendix A Summary of stakeholder consultations

Consultations

Internal FWO Consultations	Steven Ronson	FWO
	Janine Webster	FWO
Consultations with Government		
• GEERS	Justin Bell	GEERS
	Kylie Doore	GEERS
	Mike Moore	GEERS
• ATO	Grant Darmanin	ATO
• ASIC	Brett Bassett	ASIC
Consultations with non-government stakeholders		
• AIG	Jim Barrett	AIG
• ACTU	Joel Fetter	ACTU
	Emily MacMillian	United Voice
	Tim McAuley	AMWU
	Alister Kentish	CEPU Electrical Division
	Stuart Maxwell	CFMEU
	Vivian Wiles	TCFUA
Master Builders Australia	Richard Calver	Master Builders

Consultations with stakeholders occurred via face-to-face meetings and teleconference. Some stakeholders were also followed up separately.

Defining phoenix activity

Stakeholders felt the working definition was broadly appropriate. It was also noted that the Treasury definition, used as the working definition, has been endorsed by the ATO.

A number of considerations for forming an appropriate definition for phoenix activity and potential issues with the working definition were raised by stakeholders. These are summarised below.

Differentiating between phoenix activity and honest behaviour

Multiple stakeholders emphasised that the key to phoenix activity is the intent with which the liquidation occurs and any definition should highlight this. There are cases

where a business has to be liquidated and after some time, the directors are able to revive the business and continue operating. Stakeholders emphasised that in these cases of honest behaviour, the revival of businesses should not be discouraged.

Stakeholders emphasised that the difference between the honest revival of a business and phoenix activity is the intent with which the liquidation is undertaken. Stakeholders all highlighted that any definition must pick up on the deliberateness or intent with which a phoenix business liquidates in order to avoid debts.

Some stakeholders (such as the ATO) used the term 'fraudulent phoenix activity' to distinguish between the manipulation of the corporate form to avoid debts and the honest 'resurrection' of a company that had been liquidated (which was sometimes referred to as 'honest' phoenix activity). Other stakeholders used the term phoenix activity to describe only the liquidating of a company to avoid debts and used other terms for the honest resurrection of a company.

Using multiple definitions

In order to clarify the use of the term phoenix activity it was suggested that multiple terms with accompanying definitions could be used. For example, one term could be used to describe fraudulent phoenix activity, and another term for honest phoenix activity. One stakeholder also noted that it could be useful to have a range of definitions for phoenix-like behaviour.

In their submission to the Cole Royal Commission and their 1996 research paper on phoenix activity, ASIC differentiated between honest behaviour and fraudulent phoenix behaviour by analysing phoenix behaviour in terms of 'innocent phoenix operators', 'occupational hazard' and 'careerist offenders'.

Innocent phoenix operators are businesses that get into a position of doubtful solvency or insolvency due to poor business practices. One of the directors realises that the business is about to collapse and tries to recover as much as possible from the businesses. This may result in assets being transferred out of the business or assets being made available to creditors. This typically involves no contravention of the law.

Occupational hazard refers to the potentially heightened risk in some industries, such as the building and construction industry, of phoenix activity. Once a company has collapsed, the operators of the business may have little option but to return to the same industry in the form of a new business. In the case of construction, the business may have few assets, such as tools and a vehicle. The assets may be made available to creditors and therefore, no contravention of the law has occurred.

ASIC described what they termed 'careerist offenders' as those that purposefully structure their operations in order to engage in phoenix activity and avoid detection.

For the remainder of this document the term 'phoenix activity' will be used to describe fraudulent behaviour and 'honest phoenix activity' will be used to describe cases where directors are able to legally and honestly resurrect a company.

Indicators of phoenix activity

Stakeholders noted that there are a range of 'signals' or 'indicators' that phoenix activity may be about to occur. These generally occur before the company has been liquidated and thus, can be considered 'leading indicators' of phoenix activity. These 'leading indicators' include:

- the company fails to lodge tax returns and/or Business Activity Statements

- the business records and/or taxation records significantly understate or overstate the operations of the business, including debts owed
- withheld payments such as PAYGW, superannuation and child support payments are kept by the business
- workers are pressured to take leave
- workers have their employment status changed from permanent to casual
- workers are underpaid
- equipment, machinery and uniforms are not replaced as needed.

Stakeholders also noted that there are a range of common characteristics of a business that has already engaged in phoenix activity. These 'lagging indicators' of phoenix activity can include the following:

- the directors of the new entity are family members of the director of the former company or are close associates such as managers of the former business
- a similar trading name is used by the new entity
- the same business premises, assets and telephone number is used by the new entity.

Recent trends in phoenix activity

It was noted by stakeholders that phoenix activity has evolved significantly over the past decade. First, the ATO noted that they are seeing significantly less 'asset stripping' of companies than they previously did. It is now more common for the liquidated company to have no assets. This is usually because the entity is one company within a group of companies that form the business and the entity that is liquidated is the 'labour provider' and therefore, has few or no assets.

Multiple stakeholders emphasised that phoenix activity is not confined to the building and construction industry or the lower end of the Small and Medium Enterprise (SME) sector. Multiple stakeholders noted the rise of phoenix activity in the cleaning and private security industries, with one stakeholder describing phoenixing in the private security industry as being at endemic proportions. It was also noted that phoenix activity has spread from small, undercapitalised businesses to those with higher turnovers which are at the upper-end of the SME sector. Phoenix activity is also now widespread within the micro market ie. < \$2m turnover per annum.

The union stakeholders also argued that phoenix activity is counter-cyclical, meaning that when the economy enters a period of downturn or subdued growth, phoenix activity will increase. However, it is noted that genuine liquidations are also counter-cyclical and increase when the economy is in decline and decrease when the economy is growing strongly.

It was also noted by multiple stakeholders that it is often suspected that financial advisers, lawyers and insolvency practitioners are involved in some incidents of phoenix activity.

Approaches for defining phoenix activity

There are a number of approaches to defining phoenix activity that could be used. These approaches are summarised below. It should be noted that these approaches are not necessarily mutually exclusive and combinations of these approaches could be used.

1 Corporate form based definition

As phoenix activity entails the manipulation of the corporate form, it can be defined in these terms and a definition could specify the common manipulations of the corporate form that companies use to engage in phoenix activity. For example, ASIC identifies three common characteristics of phoenix activity including “within 12 months of closing, another business commences which may use some or all of the assets of the former business and is controlled by parties related to either the management or directors of the previous company”. Such a definition could include reference to the asset stripping of former business and transfer of the assets to the new business as well as the other common forms of phoenix activity (ie where one entity within a group of entities is liquidated).

There are some limitations to such a definition. A number of years ago, asset stripping was very common in phoenix activity, however now it is less so. It is now more common for the liquidated company to be the ‘services’ entity within a group of entities that form the company and for it to have few, if any, assets. The dynamic nature of phoenix activity would mean that a corporate form based definition would have to be updated to evolve with phoenix activity.

2 Debt based definition (like the working definition)

The definition used by Treasury, and used as a working definition for this project, focuses on the intent with which phoenix activity is undertaken. It implicitly specifies that what differentiates phoenix activity from honest behaviour is that phoenix activity is undertaken in order to avoid debts and other obligations.

Using a definition, such as the working definition, would ensure that honest behaviour and fraudulent behaviour are distinguished between. Additionally, in not specifying how the corporate form is manipulated in phoenix activity it would not need to be updated to keep pace with the evolution of phoenix activity. However, it arguably does not provide clarity for the community on the signs or characteristics of phoenix activity.

3 ‘Indicator’ based definition

Many stakeholders emphasised the importance of educating the community about the signs or indicators of phoenix activity. A definition could be framed around the common indicators listed on page 2. This is similar to the ASIC definition which identified three key characteristics of phoenix activity.

4 Name based definition (similar to NZ definition)

Many stakeholders noted that a name based definition (such as that enshrined in legislation in New Zealand) is quite ‘superficial’ in that it defines phoenix activity in terms of one of the common indicators, and does not address many of the other indicators. It was also highlighted that such an approach could create a moral hazard problem whereby companies still engage in phoenix activity, however change their name significantly in order to avoid fitting the legislative definition of phoenix activity. It was also noted that in some industries, for example, the building and construction industry, the trading name is not of significant importance.

5 Criminal conduct definition

Master Builders argued that the definition of phoenix activity should focus on the existing sections of corporations law and criminal law that phoenix activity breaches. It was proposed that any definition of phoenix activity should focus on the criminality of the activity.

Defining phoenix activity in legislation

Some stakeholders noted that defining phoenix activity in legislation could be beneficial if the definition was appropriate and it was accompanied by specific penalties for engaging in the activity. However, it was also noted that enshrining a narrow definition in legislation, such as that used in New Zealand, could have unintended consequences and potentially make it more difficult to address phoenix activity.

Some stakeholders also noted that the most important thing in addressing phoenix activity is not having a single definition, but ensuring that all relevant agencies and stakeholders have a sophisticated understanding of the activity and how to identify it. Union stakeholders emphasised that ensuring there is the 'necessary infrastructure and resources' to address phoenix activity is of utmost importance.

It was also raised by the ATO that if a single definition of phoenix activity was established and legislated, key issues would have to be resolved such as under what legislation would the definition be enshrined in and who would have responsibility for it?

Quantifying phoenix activity

Many stakeholders emphasised that it would be difficult to quantify phoenix activity as phoenix operators are very skilled at 'flying under the radar'. Impacts, beyond those listed in the discussion paper, that were raised by stakeholders include:

- the impact on older workers who have been long-term employees of a company that has phoenixed and may not be able to gain new employment
- the impact on government revenue of workers losing significant amounts of superannuation and therefore relying on, or relying more heavily on, pension payments
- the impact on contractors, particularly in the construction industry.

GEERS emphasised that they do not keep records of or know what proportion of payments they administer are going to former employees of phoenix companies. This is because without a clear and universally accepted definition of phoenix activity it is very difficult for GEERS to establish what proportion of payments may be going to phoenix companies. However, GEERS also noted that in the previous financial year they made \$154 million in payouts and therefore, even if only 1% were cases of phoenix activity this would be a significant amount of money in government revenue.

ASIC indicated that 533 reports, the reports compiled by liquidators and provided to ASIC, may provide some information on the approximate impact of individual cases of phoenix activity. However, they also highlighted that the reports are compiled based on the information contained in the businesses' records. In many cases this information will be limited and potentially misleading.

FWO stakeholders highlighted that there are no matters that they have been able to prove definitively as phoenix activity and this uncertainty around the number of incidents of phoenix activity will pose significant challenges for quantifying the impact. However, one approach that received a positive reception was to look at case studies of 10-15 investigations into suspected phoenix activity and estimate the FWO resources devoted to the investigation and the impacts from the case. On this basis an average cost per case of phoenix activity could be calculated which can be applied to an estimate of the number of cases of phoenix activity.

Many stakeholders raised that one of the most significant impacts of phoenix activity is on superannuation and that superannuation funds (as well as redundancy funds and long service leave funds) may be able to provide information that could be useful in quantifying phoenix activity.

Master Builders indicated that there is still a disproportionate amount of phoenix activity in the building and construction industry and that they would hear of incidents on a monthly basis. They indicated that subcontractors and smaller businesses were particularly vulnerable to phoenix activity due to the high level of 'churn' at the lower end of the building and construction industry.

Options for addressing phoenix activity

Stakeholders emphasised that a coordinated, whole of government approach is necessary to mitigate phoenix activity. Stakeholders also emphasised that options should recognise the different roles, responsibilities and resources of the ATO, ASIC and FWO. Multiple stakeholders commented that in developing options there must be an awareness of the implications of any option for risk taking and entrepreneurship.

Stakeholders were particularly enthusiastic about options that had a proactive focus, rather than a reactive focus. It was commented by one stakeholder that rather than acting in response to incidents, agencies should move towards a proactive and preventative approach.

Cross agency options

Most stakeholders noted that there has been significant progress in cross agency work on phoenix activity, with a Memorandum of Understanding (MOU) already signed between the ATO and ASIC.

Joint government education campaign and website

Out of all the options, stakeholders were perhaps most positive about a joint government education campaign. Many stakeholders highlighted that involving the community, including businesses and employees, would be essential for mitigating phoenix activity and that there is currently limited knowledge of phoenix activity in the community.

Multiple stakeholders commented that this option could be effective as a part of a broader, publicised crack down on phoenix activity which was described as a 'shock and awe' strategy to 'maximise the heat on phoenix operators'.

Stakeholders also noted that there is currently some progress towards this with agencies agreeing to have links to ATO information of phoenix activity on their websites.

Formal information sharing

Stakeholders were all very positive about increasing the level of formal information sharing between the FWO, ASIC and ATO, noting that ASIC and the ATO already have a MOU that facilitated general information sharing (though this does not specifically relate to phoenix activity). It is noted that it is not possible for there to be a MOU between more than two agencies. Therefore, there would have to be separate MOUs between FWO and ATO, and FWO and ASIC.

Statutory task force on phoenix activity

Multiple stakeholders noted that statutory task forces have significant reporting requirements. Some stakeholders expressed a preference for MOUs and a continuation of the current forum arrangement.

Insurance schemes

Stakeholders raised that the government has implemented changes to the GEERS system and is broadly happy with the GEERS approach. Therefore, it is likely that there would be little appetite for an insurance scheme.

The ATO queried whether an insurance scheme would be necessary once the reforms to director's liability were passed, as then directors would be personally pursued for outstanding employee entitlements.

Legislative options

All stakeholders were enthusiastic about the changes to director's liability that are to be introduced to parliament in the Spring session.

Joint employment provisions

Stakeholders raised that joint employment provisions are, to a certain extent, already being driven by case law and that it could be beneficial to have them defined in legislation. Stakeholders indicated that, to some extent, the courts have already shown a willingness to attribute liability for employee entitlements to the main company in a group, they have needed some evidence showing the existence of an employment relationship between the employee and the main company (albeit that other evidence may show employment with an assetless subsidiary). In such cases, however, the courts do not find the employee to have been jointly employed by both companies simultaneously, rather the findings are made on the basis that the effective legal (single) employer was the main company.

Other options and issues

The role of liquidators

Multiple stakeholders noted the reliance on the insolvency industry in investigating phoenix activity. Some stakeholders also expressed concerns about the level of independence of some liquidators and that in some circumstance, it may be in the interest of the liquidator for phoenix activity to occur. For example, some stakeholders suggested that it may be in the interest of the liquidator for the assets of the business to be sold to a family member who may then become director of the phoenixed company.

Superannuation

Union stakeholders raised that the Superannuation Guarantee Legislation is overseen only by the ATO. It was suggested that there could be greater compliance if all three agencies had a role in monitoring superannuation payments.

Cole Inquiry recommendations

The AIG and Master Builders pointed out that the Cole Inquiry made a number of recommendations regarding mitigating phoenix activity and that many of these were never implemented. It was suggested that it could be beneficial to look back at the recommendations of previous inquiries and studies to complete a 'stocktake' of recommendations that had been implemented and those that had not been implemented.

Automatic transfer of liabilities and litigation to new entity

Union stakeholders suggested that the liabilities of the previous company could be automatically transferred to the new company if they are operating under the same name or if it can be proven that phoenix activity has occurred.

Summary of stakeholder consultations

Changes to director's liability

Broadly stakeholders were supported of the planned changes to director's liability. However, one stakeholder indicated that they believe the changes were ill-conceived and indicated that a re-examination of the changes proposed in the Cole Inquiry could be more effective in addressing phoenix activity.

