

PARLIAMENT OF VICTORIA

LAW REFORM COMMITTEE

CURBING THE PHOENIX COMPANY

THIRD REPORT
ON THE LAW RELATING TO DIRECTORS AND
MANAGERS OF INSOLVENT CORPORATIONS

REPORT TO THE PARLIAMENT ON
THE RESPONSE OF THE COMMONWEALTH
ATTORNEY-GENERAL TO THE COMMITTEE'S
RECOMMENDATIONS CONTAINED IN ITS
FIRST AND SECOND REPORTS

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MEMBERSHIP

MEMBERSHIP OF THE LAW REFORM COMMITTEE FOR THIS REPORT

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- Mr Neil Cole, MP, Deputy Chair
- Dr Robert Dean, MP
- Hon Bill Forwood, MLC
- Mr Peter Loney, MP
- Hon Jean McLean, MLC
- Mr Peter Ryan, MP
- Dr Gerard Vaughan, MP
- Mr Kim Wells, MP
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FUNCTIONS OF THE COMMITTEE

PARLIAMENTARY COMMITTEES ACT 1968

4E. The functions of the Law Reform Committee are—

- (a) to inquire into, consider and report to the Parliament where required or permitted so to do by or under this Act, on any proposal, matter or thing concerned with legal, constitutional or Parliamentary reform or with the administration of justice but excluding any proposal, matter or thing concerned with the joint standing orders of the Parliament or the standing orders of a House of the Parliament or the rules of practice of a House of the Parliament;
- (b) to examine, report and make recommendations to the Parliament in respect of any proposal or matter relating to law reform in Victoria where required so to do by or under this Act, in accordance with the terms of reference under which the proposal or matter is referred to the Committee.

TERMS OF REFERENCE

To inquire into and report to Parliament as to—

1.1 The adequacy of the existing disqualification procedures where company directors and persons acting in the management of companies have been involved in failed companies and in particular the adequacy of section 599 of the Corporations Law as a means of achieving creditor protection.

1.2 The adequacy of penalties imposed where disqualified persons act in the management of companies.

1.3 The adequacy of existing supervisory and enforcement arrangements in relation to disqualified persons.

2.1 Whether the Corporations Law provides appropriate remedies against directors and effective execution against directors' personal assets where those directors have been involved in the management of companies which have failed to meet financial obligations.

2.2 Whether the Corporations Law provides appropriate means of tracing, for the benefit of creditors, assets divested by company directors.

2.3 Whether the Supreme Court of Victoria and the Federal Court of Australia are appropriate forums for civil actions against directors (for instance under section 592 of the Corporations Law) having regard to the costs of such actions.

2.4 What other safeguards might be introduced to protect creditors in their dealings with companies.

3.1 The means by which Victoria might implement any recommendations arising out of this inquiry.

In the conduct of its reference, the committee should have regard to—

(i) The necessity to regulate the formation of new companies by persons who have been directors of or have been involved in the management of recently failed companies or companies unable to pay their debts;

(ii) The measures that may be taken to control the participation of such persons, either as consultants or by any other form of employment or engagement, whether or not remunerated, in other newly created or existing companies by individuals related to them.

(iii) Measures that may be taken to prevent companies and their operators from avoiding their liabilities by starting again under a new name.

Victoria Government Gazette, G1, 7 January 1993, pp. 53-54 (original terms of reference)

Victoria Government Gazette, G12, 25 March 1993, pp. 711-712 (amended terms of reference)

Victoria Government Gazette, G25, 1 July 1993, p. 1772 (extension of time to Autumn 1994 Session)

THE COMMONWEALTH ATTORNEY-GENERAL'S RESPONSE TO THE COMMITTEE'S RECOMMENDATIONS

1.1 In early 1993 the Law Reform Committee was given a reference by the Governor-in-Council to inquire into and report to Parliament on the adequacy of provisions in the *Corporations Law* concerning the phoenix company phenomenon. The phoenix company is a company of limited liability that fails and is unable to pay its debts to creditors, employees and the State. At the same time, or soon afterwards, the same business rises from the ashes of the former company with the same directors or management, under the guise of a new limited liability company, but disclaiming any responsibility for the debts of its predecessor, sometimes with a similar name and operating from the same premises.

1.2 The Committee published its First Report, *Curbing the Phoenix Company*, in June 1994. It did this after examining the provisions of the *Corporations Law* that had been referred to it and the recent amendments that had been made to that legislation. In addition, the Committee took account of numerous written submissions and oral evidence. As a result of that examination the Committee made fourteen recommendations.¹ These included recommendations that the Victorian Government should seek the support of the Ministerial Council for changes to the *Corporations Law* as follows—

1. ... the directors of a failed company which is struck off without a formal liquidation and which pays less than 50¢ in the dollar of its liabilities are subject to the same sanctions as if there had been a formal liquidation and an adverse liquidator's report.
2. ... for a change to the disqualification provisions in s. 600 of the *Corporations Law*. There should be two levels: where a corporation is liquidated and pays less than 50¢ in the dollar of its liabilities the ASC should have a discretion to require a director of the corporation to show cause why he or she should not be disqualified; and when a person is involved as a director or manager in

¹ The Recommendations made in the First Report are reproduced in Appendix I to this Report.

two such insolvencies the disqualification should be automatic unless the director can satisfy the ASC otherwise.

3. ... for a change to section 599 of the *Corporations Law*. That section should enable the Court to disqualify a director if satisfied at the civil standard of the matters of mismanagement now requiring proof beyond reasonable doubt, and in the event of only a single insolvency.

1.4 In May 1995 the Committee published its Second Report which examined the law in a number of overseas jurisdictions to ascertain what was being done to curb the phoenix company phenomenon. A comparative analysis of the most relevant overseas legislation with certain Australian legislative provisions was presented. The Second Report discussed the legislative provisions in the United Kingdom, New Zealand, Canada, Malaysia, Singapore and Germany, and made nine recommendations.² Following this review the Committee recommended, inter alia, that –

Recommendation 3 and Recommendation 4 of this report be substituted respectively for Recommendation 3 and Recommendation 2 of the First Report. Otherwise the Recommendations made in the First Report be confirmed.

1.5 Recommendation 3 and Recommendation 4 of the Second Report are as follows –

3. The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* by the inclusion of a provision which deals with the duty of a court to disqualify a person from acting as a company director where that person has been a director of an insolvent corporation and his or her conduct as a director makes him or her unfit to continue acting in the management of any corporation. Such a provision should be in substitution for section 599 of the *Corporations Law* and should be modelled on section 383 of the *New Zealand Companies Act 1993*.
4. The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* by replacing section 600 of the *Corporations Law* with a provision similar to that contained in section 385 of the *New Zealand Companies Act 1993* which deals with the exclusion by the regulatory authority of certain persons from the management of companies. However, the Committee recommends that, in lieu of the New Zealand provision's requirement that a person may be prohibited by the regulatory authority from being a director or promoter of a company if he/she has taken part in the management of two or more failed companies, there should be a two tiered approach: where a corporation is liquidated and pays less than fifty cents in the dollar of its liabilities the ASC should have a discretion to require a director to show cause why he or she should not be disqualified; and when a person is involved as a director or

² The Recommendations made in the Second Report are reproduced in Appendix II to this Report.

manager in two such insolvencies the disqualification should be automatic unless the person can satisfy the ASC otherwise.

1.6 In Recommendation 5 the Committee further recommended that—

the Victorian Government should seek the support of the Ministerial Council for an amendment to section 229 of the *Corporations Law*, which currently provides that on conviction for certain specified offences a person is disqualified from managing a corporation for a period of five years. The Committee recommends that there should be a minimum disqualification period of two years and an increased maximum disqualification period of fifteen years.

1.7 In the Second Report the Committee recognised the fact that because many of its recommendations would require amendments to the *Corporations Law*, and in such matters Victoria should rarely act unilaterally, the changes would need to be made on a national basis. In furthering this end, the Committee has liaised closely with the Commonwealth Attorney-General's Corporations Law Simplification Task Force (the Task Force) over a number of months.

1.8 The Task Force was established in 1993 within the Commonwealth Attorney-General's Department with the central objective 'to simplify the *Corporations Law* and make it capable of being understood so that users can act on their rights and carry out their responsibilities'.³ In seeking to achieve this objective, the Task Force's aim is—

to streamline the law, procure consistency and coherence, strip away unnecessary complexities, maintain effective protection for investors, and bring significant cost benefits both to business in complying with the law and to relevant authorities in administering it.⁴

1.9 On 1 August 1995 the Commonwealth Attorney-General announced that as part of stage 3 of the simplification program 'the Task Force will also be examining the question of the "phoenix company"'.⁵ The Attorney said—

The Task Force is considering a tightening up of the rules concerning the disqualification of those who abandon from their company without following the procedures provided for by the *Corporations Law*. [The Task Force] will have the

³ Attorney-General's Department, *Corporations Law Simplification Program, Task Force Plan of Action*, December 1993 (hereafter *Task Force, Plan of Action*), [1].

⁴ *id.*, [2].

⁵ M. Lavarch, 'Corporations Law simplification—opening address to simplification seminar, Brisbane, 1 August 1995', 7.

benefit of a report on this topic by the Victorian Parliamentary Law Reform Committee.⁶

1.10 In October 1995 the Task Force published its proposal for simplifying the provisions of the *Corporations Law* relating to company officers and related party transactions.⁷ In presenting its proposals the Task Force acknowledges that it has taken account of the Committee's recommendations.⁸

1.11 Under the proposal sections 229, 599 and 600 of the *Corporations Law* will be replaced by the following provisions –

- a. A power in the Australian Securities Commission (ASC) to disqualify a person from being a director or managing a company for up to ten years if the ASC is satisfied, inter alia, that the person was a director or executive officer of a corporation which was deregistered by the ASC for failing to lodge documents with creditors not being fully paid, or which was wound up with creditors not being fully paid, or which ceased to carry on business because of its inability to pay its debts, and in any of these situations the corporation was mismanaged and the director's or executive officer's conduct in relation to the management, business or property of one or more corporations justifies the disqualification.⁹
- b. A person will be automatically disqualified from managing a company for ten years if a person has been convicted of any of a number of specified offences. The ASC will have a discretion to reduce the period from ten to a minimum of two years.¹⁰
- c. A person will be disqualified from managing a company if he or she commits any of a number of specified acts relating to the bankruptcy law.¹¹

⁶ *ibid.*

⁷ Attorney-General's Department, *Corporations Law Simplification Program, Officers and related party transactions – Proposal for simplification*, October 1995 (hereafter 'Task Force, *Officers*).

⁸ *id.*, 8.

⁹ *id.*, 2-3.

¹⁰ *id.*, 3.

¹¹ *id.*, 4.

1.12 If adopted these proposals will give effect to a number of the recommendations made in the Committee's Reports as follows –

- a. The extension of the disqualification provisions to directors of companies which are deregistered by the ASC without a formal liquidation.¹²
- b. The extension of the disqualification provisions to cover directors involved in one company failure. Under the existing provisions the director must have been involved in the management of two companies that fail. The Task Force agreed with the Committee's recommendation to this effect on the basis of 'the discretionary nature of the ASC's power to disqualify'.¹³
- c. The increase in the disqualification period because of a conviction of an offence from five to ten years. The Committee recommended an increased maximum disqualification period of fifteen years and a minimum disqualification period of two years.¹⁴ The Task Force has settled on a maximum of ten years, but has raised specific issues as to whether either the increased maximum or the minimum disqualification periods should be adopted instead of the ten years preferred by the Task Force.¹⁵
- d. It is likely that the Task Force's proposals will bring together in the one part of the *Corporations Law* all the provisions relating to the disqualification of company directors.¹⁶ This is in accord with Recommendation 7 of the Committee's *Second Report*.¹⁷

¹² id., 8-9.

¹³ id., 9.

¹⁴ Parliament of Victoria, Law Reform Committee, *Curbing the Phoenix Company – Second Report*, L.V. North, Government Printer, Melbourne, 1995 (hereafter *Second Report*), 38.

¹⁵ Task Force, *Officers*, 2, 9.

¹⁶ See Task Force, *Plan of Action*, [2]; Attorney-General's Department, Corporations Law Simplification Program, *Drafting Issues – Organising the Law*, June 1995, 10-11.

¹⁷ *Second Report*, 50.

1.13 In addition to the current proposals, the Committee notes that another aspect of the Task Force's review of the directors' disqualification provisions in the *Corporations Law* is still to be resolved, that is, the re-use of the names of failed companies by people associated with those companies.¹⁸ A recommendation regarding this issue was made in the Committee's *First Report* as follows –

The Committee recommends that Victoria legislate to place restrictions on the use of business names similar to those of a failed corporation by persons associated with the failed corporation, except with leave of the court, based on sections 216 and 217 of the *Insolvency Act 1986* (United Kingdom); and that the Victorian Government seek to persuade the other Australian jurisdictions to do likewise.¹⁹

1.14 The Committee is pleased that through its reports on *Curbing the Phoenix Company* it has been able to advance important reforms to the *Corporations Law*. The Committee looks forward to a positive response from the Victorian Government to the Committee's recommendations made in the two reports, especially those which recommend action by Victoria in its area of legislative competence.

¹⁸ Attorney-General's Department, *Corporations Law Simplification Task Force, Company Names: Proposals for Simplification*, Canberra, November 1994, p.3.

¹⁹ Parliament of Victoria, Law Reform Committee, *Curbing the Phoenix Company – First Report*, L.V. North, Government Printer, Melbourne, 1994, 53.

APPENDIX I

RECOMMENDATIONS MADE IN THE FIRST REPORT

Recommendation 1

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* so that the directors of a failed company which is struck off without a formal liquidation and which pays less than 50¢ in the dollar of its liabilities are subject to the same sanctions as if there had been a formal liquidation and an adverse liquidator's report.

Paragraph 3.1.25

Recommendation 2

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* so that the ASC have under s.600 in relation to a director of a single failed company which is liquidated and which pays less than 50¢ in the dollar of its liabilities the same discretion as it now has when there are two such insolvencies to require the director to show cause why he or she should not be disqualified, and that where a director would now be subject to the ASC's discretion the disqualification be automatic unless the director can satisfy the ASC otherwise.

Paragraph 3.1.26

Recommendation 3

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* so that section 599 enables the Court to disqualify a director if satisfied at the civil standard of the matters now requiring proof beyond reasonable doubt, and in the event of only a single insolvency paying creditors less than 50¢ in the dollar.

Paragraph 3.1.28

Recommendation 4

The Committee recommends that the Victorian Government should seek a review of the resources devoted to detecting and prosecuting persons who involve themselves in the management of companies while disqualified.

Paragraph 3.2.21

Recommendation 5

The Committee recommends that the Victorian Government should take steps to change the public and judicial attitudes to corporate crime, so that persons who manage companies when disqualified or whose culpable management leads to serious losses to creditors are as likely to go to prison as those who deprive others of similar sums of money by theft or burglary.

Paragraph 3.2.21

Recommendation 6

The Committee recommends that the Victorian Government should encourage the ASC to give a higher priority to developing computer programs to detect disqualified persons becoming involved in the management of companies.

Paragraph 3.3.10

Recommendation 7

The Committee recommends that the Victorian Government should take steps both by itself and in cooperation with the other members of the Ministerial Council to secure wider and more regular dissemination of the register of disqualified directors, and should urge banks and other financial institutions to make use of this information so as to make it harder for disqualified persons to manage companies.

Paragraph 3.3.11

Recommendation 8

The Committee recommends that when a liquidator takes a bona fide action against directors or managers of a corporation to recover property of the corporation or to secure compensation for the corporation the Court should not be able to make an order for costs or

an undertaking as to damages against the liquidator personally, and the inability of the corporation to provide security for costs or damages should not be a bar to the action proceeding; but that such an action should be subject to the leave of the Court; and that in these circumstances the costs and damages of a successful defendant should have priority over all other claims on the corporation's assets.

Paragraph 4.1.43

Recommendation 9

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* to create a statutory process analogous to a Mareva injunction to enable the courts to freeze assets of a director or manager which are *prima facie* assets on which the corporation has a just claim.

Paragraph 4.1.44

Recommendation 10

The Committee recommends that the enforcement of money judgments be made the subject of a separate inquiry.

Paragraph 4.1.45

Recommendation 11

The Committee recommends that Victoria legislate to place restrictions on the use of business names similar to those of a failed corporation by persons associated with the failed corporation, except by leave of the court, based on sections 216 and 217 of the *Insolvency Act* 1986 (United Kingdom); and that the Victorian Government seek to persuade the other Australian jurisdictions to do likewise.

Paragraph 4.4.18

Recommendation 12

The Committee recommends that the Victorian Government fund Small Business Victoria to investigate the dimensions of the risk to small business posed by the phoenix company phenomenon, and to develop and evaluate a training package to help small businesses improve their credit assessment and credit management.

Paragraph 4.4.22

Recommendation 13

The Committee recommends that the Victorian Government investigate requiring State licensing and registration bodies to take account of a person's previous involvement with a company which failed without paying its creditors.

Paragraph 4.4.23

Recommendation 14

The Committee recommends

- that the Government allocate funds to establish a 12 month pilot program within the State Revenue Office or the WorkCover administration to provide funds to liquidators to do more detailed investigations and reports on failed companies where there may be an action against the directors or managers, and where appropriate to take action to recover assets from them
- that the goal of the pilot be to assess whether successful recovery actions would provide sufficient funds (which would previously have been written off) to cover the costs of the unsuccessful investigations and actions
- that the Government report to the Parliament within twelve months of the conclusion of the pilot program whether the pilot program meets its objectives, giving details of the cost, the number of phoenix companies detected, the amounts recovered for the State, and the amounts recovered for business creditors who would otherwise have got nothing.

Paragraph 5.1.14

Recommendation 15

The Committee recommends that it be given the opportunity to make a second report on the present terms of reference, so as to be able to take into account the responses to this First Report and the results of cases before the courts using the amendments to the *Corporations Law* introduced by the *Corporations Law Amendment Act 1992* in June 1993.

Paragraph 5.1.23

APPENDIX II

RECOMMENDATIONS MADE IN THE SECOND REPORT

Recommendation 1

Confirmation of Previous Recommendations

The Committee recommends that Recommendation 3 and Recommendation 4 of this report be substituted respectively for Recommendation 3 and Recommendation 2 of the First Report. Otherwise the Recommendations made in the First Report be confirmed.

Paragraphs 1.16, 3.30, 3.34, 3.45, 3.50

Recommendation 2

Corporations Considered to be at Risk of Financial Failure

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* by the inclusion of provisions similar to those contained in the New Zealand *Corporations (Investigation and Management) Act 1989* which apply to corporations considered to be at risk of financial failure and which seeks to prevent further deterioration in the financial affairs of those corporations and to protect the public interest.

Paragraph 2.45

Recommendation 3

Disqualification of Directors by the Court

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* by the inclusion of a provision which deals with the duty of a court to disqualify a person from acting as a company director where that person has been a director of an insolvent corporation and his or her conduct as a director makes him or her unfit to continue acting in the management of any corporation. Such a provision should be in substitution for section 599 of the *Corporations Law* and should be modelled on section 383 of the New Zealand *Companies Act 1993*.

Paragraph 3.13

Recommendation 4

Disqualification of Directors by the Commission

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* by replacing section 600 of the *Corporations Law* with a provision similar to that contained in section 385 of the New Zealand *Companies Act 1993* which deals with the exclusion by the regulatory authority of certain persons from the management of companies. However, the Committee recommends that, in lieu of the New Zealand provision's requirement that a person may be prohibited by the regulatory authority from being a director or promoter of a company if he/she has taken part in the management of two or more failed companies, there should be a two tiered approach: where a corporation is liquidated and pays less than fifty cents in the dollar of its liabilities the ASC should have a discretion to require a director to show cause why he or she should not be disqualified; and when a person is involved as a director or manager in two such insolvencies the disqualification should be automatic unless the person can satisfy the ASC otherwise.

Paragraph 3.21

Recommendation 5

Disqualification of Directors on Conviction

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for an amendment to section 229 of the *Corporations Law*, which currently provides that on conviction for certain specified offences a person is disqualified from managing a corporation for a period of five years. The Committee recommends that there should be a minimum disqualification period of two years and an increased maximum disqualification period of fifteen years.

Paragraph 3.28

Recommendation 6

Assetless Companies Fund

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for the establishment of an Assetless Companies Fund as recommended by the Australian Law Reform Commission in its Report No. 45, *General Insolvency Inquiry* (1988) to provide a fund from which payments could be made so as to enable the winding up of and investigations into insolvent assetless companies.

Paragraph 3.53

Recommendation 7**Grouping of Provisions relating to Directors**

The Committee recommends that the Victorian Government should seek the support of the Ministerial Council for a change to the *Corporations Law* which would ensure that all provisions dealing with directors duties, obligations, liabilities, disqualification and associated offences and penalties are contained within the one part of the *Corporations Law*.

Paragraph 4.6

Recommendation 8**Public Awareness Education and Advertising Programs**

The Committee recommends that the Victorian Government should fund Small Business Victoria and the Office of Fair Trading and Business Affairs to design and conduct education and advertising programs targeted at those most at risk, and aimed at increasing general public awareness of the risks that may be inherent when dealing with limited liability companies.

Paragraph 4.7

Recommendation 9**Increasing Public Awareness of the Use of Guarantees**

The Committee recommends that the Victorian Government should take steps to increase the general public awareness of the use that can be made by persons dealing with limited liability companies, of guarantees which are designed to protect those persons' financial position. The preparation and distribution of a standard form of guarantee, to be given by company directors to secure their company's financial liabilities, would be a cost effective means of improving the situation of creditors, especially those likely to be confronted by the phoenix company phenomenon.

Paragraph 4.8



News
Release

-----ATTORNEY-GENERAL-----

-----THE HON. MICHAEL LAVARCH MP-----

97/95

28 October 1995

CLIPPING THE WINGS OF PHOENIX COMPANIES

Directors of companies which fold leaving unpaid debts may be barred from directing another company for up to 10 years under a proposal released today by the Attorney-General, Michael Lavarch.

The proposal, the first in Stage Three of the Corporations Law Simplification Program, aims to substantially increase the scope for action by the Australian Securities Commission against the use of companies to avoid responsibilities to creditors.

It will also double the maximum disqualification period from five to 10 years.

"There have been too many instances where the principle that investors in companies are liable only to the extent of their investment has been abused," Mr Lavarch said.

The phenomenon is known as the "phoenix company" problem: where a company is wound up leaving unpaid debts and, soon afterwards, a second company with the same operators takes up the business of its predecessor.

"Often it operates from the same premises or with the same staff, but disclaims any responsibility for the debts of its predecessor," Mr Lavarch said.

"In many of the most callous cases, the creditors left out in the cold include former staff who have not been paid their wages or severance entitlements."

Under the existing law, the directors of such companies may be disqualified by the ASC after two instances where liquidators' reports show less than 50 cents in the dollar is available for unsecured creditors. However many "phoenix companies" are left with no assets so there is no liquidators' report. The courts have discretion to disqualify directors in some other circumstances, but this can involve lengthy delays.

The simplification proposal tackles the problem by broadening the ASC's discretion to disqualify the directors of any company that has failed with unpaid creditors where there is evidence of mismanagement or improper conduct.

"This will provide greater protection for workers, creditors and company members." Mr Lavarch said. "For example, the ASC's powers to disqualify will extend to directors of a deregistered company, even if that company has not gone through a formal liquidation."

The proposal also removes the need for proprietary companies to appoint a secretary. However public companies will have to retain the office of secretary. The proposal will also tighten up the rules concerning transactions with people who are closely related to the company or its directors.

This is the first proposal released as part of the preparation of an exposure draft of the Third Corporate Law Simplification Bill for release during 1996.

The First Corporate Law Simplification Act 1995 was passed in September and will come into force by early December, eliminating the need for small proprietary companies to lodge annual accounts, allowing single person companies and substantially simplifying the rules governing share buy backs. The Second Corporate Law Simplification Bill is currently being finalised. It will deal with registering a company, meetings, share capital, financial statements and audit and annual returns.

Copies of the latest proposal are available from Simone Marks on (06) 250 6104. Comments are due by 25 January 1996.

Media contacts: Mark Lever (Attorney-General's Office) (06) 277 7300
or 0419 206 005

Megan Bonny (Attorney-General's Dept) (06) 250 6589

Officers and related party transactions

Proposal for simplification

This proposal covers the provisions in the Corporations Law concerning:

- officers (Part 3.2)
- related party transactions (Part 3.2A).

As foreshadowed in the Plan of Action for Stage 3, the Task Force has not reviewed the fundamental policy for those provisions which were recently amended following extensive consultation.

Because of their close relationship with the officers and related party provisions, the rules on oppression and civil penalties will be rewritten as part of this project. The Task Force does not propose to review the policy underlying these provisions, but welcomes comments on them.

Officers

The proposal will:

- give proprietary companies the option of not appointing a company secretary
- allow the ASC to disqualify a person from managing a company if:
 - the person has been an officer of a corporation that has left creditors unsatisfied because it was mismanaged, and
 - the person's conduct in relation to a corporation justifies their disqualification
- require directors of all companies to disclose material personal interests they have in the affairs of the company
- rewrite the existing statutory duty for officers to act honestly.

Related party transactions

The proposal will:

- take into the Law a definition of control based on the one used in the accounting standards
- make it clear that shareholder approval is not required where shares issued or options granted to directors form part of their reasonable remuneration
- simplify the rules for shareholder approval of related party transactions.

Benefits of the proposal

The proposal will:

- give greater flexibility for the management of proprietary companies and avoid the need for a person to be appointed both a director and secretary for a 1 person company
- enhance the power of the ASC to disqualify from managing companies a director or executive officer of a corporation which has left creditors unpaid in circumstances where their conduct requires disqualification in the public interest
- clarify the existing officers' duty to act honestly
- require greater disclosure of directors' conflicts of interest
- clarify the scope of the remuneration exception in Part 3.2A
- allow the reasonableness of an indemnity given, or insurance premium paid, to be assessed without regard to other benefits given to the director.

Proposal

Issues for consideration

and

(b) the corporation was mismanaged,

and

(c) their conduct in relation to the management, business or property of 1 or more corporations justifies the disqualification.

The ASC will not be able to disqualify a person unless it has first given them an opportunity to be heard.

Automatic disqualification – offences

4. A person will be automatically disqualified from managing a company for 10 years if they have been convicted:

(a) of an offence concerning the management of a corporation punishable by at least 12 months imprisonment

(b) of an offence involving dishonesty punishable by at least 3 months imprisonment

(c) of an offence against:

(i) section 590 (concealment of company property or books)

(ii) section 595 (inducement to be appointed liquidator, administrator, receiver etc.)

(iii) Part 6.6 mis-statements relating to takeovers)

(iv) Division 2 of Part 7.11 (offences relating to securities, including continuous disclosure breaches)

(v) Division 2 of Part 8.7 (offences relating to futures)

(vi) section 1307 (falsification of books) .

The ASC will be able to reduce the period, but there will be an absolute minimum of 2 years.

(e) Should it be an alternative to (b) that the manner in which the corporation was managed adversely affected the position of creditors?

(f) If a person satisfies paragraph (a) twice in 7 years, should the onus be on them to show that paragraphs (b) and (c) do not apply?

(a) Would a longer period of disqualification be more appropriate?

(b) Are there any other offences for which automatic disqualification would also be appropriate?

Proposal

Issues for consideration

Automatic disqualification – insolvents

5. A person will be disqualified from managing a company if:
 - (a) they are an undischarged bankrupt
 - (b) they have executed a deed of arrangement under Part X of the Bankruptcy Act within the preceding 3 years
 - (c) their creditors have accepted a composition under Part X of the Bankruptcy Act within the preceding 3 years
 - (d) they have executed a deed of assignment under Part X of the Bankruptcy Act within the preceding 3 years
 - (e) their property is subject to control under sections 50 or 188 of the Bankruptcy Act.

Waiver and review of disqualification

6. During a period of disqualification, the ASC may allow a person to manage a company with or without conditions. This will not apply to an automatic disqualification because of insolvency.
7. The exercise of the ASC's powers under paragraphs 3 and 6 will be subject to review by the Administrative Appeals Tribunal.

Should this apply during the first 2 years of an automatic disqualification because of a conviction of an offence?

Development of the proposal – officers

Disqualification of directors

ASC disqualification – company failures

The ASC, the Parliamentary Joint Committee on Corporations and Securities and the Victorian Law Reform Committee (VLRC) have all expressed concern about the 'phoenix company' phenomena. The 'phoenix company' phenomena refers to a situation where:

- a company fails without being able to pay its debts, and
- soon afterwards a second company takes up the business of its predecessor, with the same operators, but disclaims any responsibility for the debts of its predecessor.

In its May 1995 report *Curbing the Phoenix Company* the VLRC made a number of recommendations which would enhance the ASC's power to disqualify the directors of a phoenix company from the management of companies. This proposal takes account of those recommendations.

Section 600 currently provides a means for the disqualification of directors of phoenix companies. However, section 600 applies only where the person has been a director of 2 companies in relation to which a liquidator has lodged with the ASC a report indicating that the company may not be able to pay its unsecured creditors more than 50 cents in the dollar. Typically, the phoenix company problem arises where a company has no assets, making it unlikely that creditors will have a liquidator appointed to it. Instead, the company is likely to be deregistered by the ASC without a formal liquidation.

Under subsection 601AB(1), to be inserted by the draft Second Corporate Law Simplification Bill, the ASC may deregister a company without a formal liquidation if:

- the company's annual return is at least 6 months late, and
- the company has not lodged any other documents under the Law in the last 18 months, and
- the ASC has no reason to believe that the company is carrying on business.

The proposal will allow the ASC to disqualify a person who has been a director or executive officer of a company that has been deregistered under subsection 601AB(1).

Section 599 currently allows the Court to disqualify a person in certain circumstances. It is proposed that the ASC should have a discretion to disqualify a person in those circumstances. This will allow persons who should not remain as directors to be removed quickly, while at the same time giving them appropriate appeal rights. It also provides the ASC with the necessary powers to carry out its legislative function of monitoring persons involved in managing companies.

The VLRC considered that the ASC should be able to disqualify a person who has been a director of 1 company, it is not considered necessary to have automatic disqualification where there are 2 companies. The Task Force does not therefore support this recommendation.

Automatic disqualification – offences

The Court will retain its current powers to prohibit a person from managing a corporation where they have breached:

- certain officers' duties or repeatedly contravened the Law (section 230)
- a civil penalty provision (paragraph 1317EA(3)(a)).

There is no significant change proposed to the grounds for automatic disqualification under current subsection 229(3). Subsection 229(3) applies to persons convicted of indictable offences in relation to the management of a corporation, serious fraud, offences under the civil penalty provisions and certain other offences. The Task Force invites comment on whether there are any other offences for which automatic disqualification would be appropriate.

Period of disqualification

The VLRC recommended that, for an automatic disqualification because of a conviction of an offence, there should be an increased maximum disqualification period of 15 years and a minimum disqualification period of 2 years.

However, it was considered that it would not be appropriate to disqualify a person for a period as long as 15 years, and that 10 years would be a sufficient reflection of the seriousness of improper conduct by directors.

Automatic disqualification –insolvents

Section 224 provides that the office of company director will automatically be vacated when the director becomes an 'insolvent under administration'. Under subsection 229(1), an insolvent under administration is prohibited from managing a corporation without the leave of the Court.

At present, a person will be an insolvent under administration if they:

- are an undischarged bankrupt under the Bankruptcy Act, or
- have executed a deed of arrangement under Part X of the Act where the terms of the deed have not been fully complied with, or
- have entered into a composition under Part X where a final payment has not been made under that composition.

A person may be subject to an arrangement or composition under Part X for a very long time, for example, if a deed of arrangement provided for the assignment by a debtor of a remainder interest in property subject to a life estate. If the life tenancy continued for 20 years from the date of the deed, the person would remain disqualified from managing a corporation for that period.

Under the proposal, a person who has entered into an arrangement or composition under Part X will be automatically disqualified for 3 years from managing a corporation. The disqualification should run for 3 years because this is the usual period of bankruptcy. debtor's creditors, the debtor dies or the debtor's property is released from control. It seems appropriate that a person whose property is subject to control under section 50 or 188 of the Bankruptcy Act should be disqualified from managing a corporation.

This proposal is in line with the general approach to the disqualification of insolvents in Commonwealth legislation, in particular, the Superannuation Industry (Supervision) Act 1993.

Waiver and review of disqualification

The ASC will be able to waive disqualification with or without conditions.

As at present, the ASC's decisions in relation to the disqualification of directors will be subject to review by the Administrative Appeals Tribunal. Decisions relating to the waiver of a disqualification will also be reviewable.