ELLEMWARREN
LAWYERS

ILLEGAL PHOENIX ACTIVITY: *THE DISORDER OF THE PHOENIX*

Illegal phoenix activity has recently come under intense scrutiny from ASIC, with directors being exposed to expanded liabilities and harsh penalties.

What is Illegal Phoenix Activity?

From time to time, businesses fail purely out of bad luck, despite being responsibly managed. After liquidation, directors are within their rights to continue in business using another corporate entity. What is not acceptable, however, is acting against the interests of the failing company, including using or moving its assets – e.g. goodwill, branding, phone and website, as well as cash or physical assets – to help 'breathe life' into a new company, leaving the failed company unable to satisfy the debts owed to employees, creditors and the tax office.

Illegal phoenix activity commonly involves the following characteristics:

- A company is unable to pay its debts or otherwise satisfy its obligations;
- A new company commences, usually within 12 months, with the same or similar management and business;
- Some or all of the assets from the failing company transfer to the new company and unsecured creditors are denied access to the assets;
- The new company employs staff that had previously been terminated from the failed company.[1]

The role of ASIC

ASIC may take administrative action to wind up abandoned companies and it has a surveillance campaign and funding to investigate illegal phoenix activity. Where phoenix activity is detected, ASIC may take action against parties involved, including legal, accounting or other advisors involved in facilitating the illegal activities.

Consequences for Directors

In small to medium enterprises, it is common to find directors with little understanding of the obligations imposed by the law vis-à-vis "their" company. As usual, ignorance of the law is no excuse. The company is a distinctly separate legal entity from the director, and the director owes duties to act in its interest, distinct from his/her own interests. Where the company is 'flirting' with insolvency, the interests of creditors cannot be disregarded. If directors disadvantage a failing company to benefit a new company or themselves they may be disqualified from managing corporations for an extended period of time.[2]

Consequences for Advisors

Advisors who, with knowledge of the relevant facts, advise on or recommend a transaction which contravenes the *Corporations Act 2001* may be held to have aided and abetted the transaction, thereby breaching their statutory duties.[3]

There are lawful and effective ways to restructure, however, many advisors do not have the expertise to step a client (and themselves) through this 'mine-field' unscathed. We do.

For further information about solvency issues, structuring for asset protection, or director duties, please contact:

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[1] Australian Securities and Investments Commission, *Small Business: Illegal Phoenix Activity* (2014) <https://www.asic.gov.au>.

[2] *ASIC v Sommervile* (2009) 77 NSWLR 110 [111].

[3] *ASIC v Sommervile* (2009) 77 NSWLR 110; *Corporations Act 2001* (Cth) s 79.