Are you dealing or contracting with an Illegal Phoenix Company?

May 28, 2018

Written by JHK Legal Lawyer Hayley Tibbie

The term 'Phoenix Company' is used when a company has deliberately shut down due to indebtedness, and the directors of that company start up a new company to re-commence trading in attempt to avoid the former company's debt. It's important to understand that there is legal and illegal phoenix activity.

Illegal phoenixing means that the directors involved will transfer the assets of the former company to a new company for little or no consideration and commence trading under the same trading terms it may have with its suppliers and/or customers. However, for suppliers and/or creditors, this can be a problem where there is a default and the former contracts with the former entity will not be enforceable against the new company, even though the new company is the one that holds the assets (and the money).

Identifying an Illegal Phoenix Company

While it may be difficult for creditors to identify whether a company may be an illegal phoenix company, there are a few key factors that can assist in identifying whether a business is engaging in illegal Phoenix behaviour or is otherwise a legitimate entity. Key factors of identification include:

1. If the company owes money and appears to be indebted; and
2. If the trading name of the company changes, but they have the same staff, managers and directors; and

JHK LEGAL

3. If the company closes down for a period of time and re-opens within 12 months and commences trading, either in the same location or a different location with a new trading name.

As it can be difficult to ascertain whether you are dealing with an illegal phoenix company, we suggest the following due diligence checks are undertaken regularly in your business practices to avoid the predicament of being a creditor unable to enforce:

1. Review your consumer contracts regularly. This includes identifying contracts that may be a few years old and running a free Australian Securities and Investments Commission ("ASIC") search on those entities to ensure that the entity is still a registered entity. If they are no longer registered, and you have been still supplying to the entity, then you will need to ask the directors of the company to execute a new supply contract. This will ensure that you are protected against your supply to the new entity;

2. Ensure your contracts have personal guarantees signed by directors. This will provide security to you if the company does close, becomes de-registered or goes into liquidation. It will allow you to pursue the directors personally for any debt owed by the former company or any newly established company which that director has created;

3. Ensure that when your customer completes your contract and provides you with their company details that you undertake an ASIC search to ensure it is a registered entity. It is imperative that you check the ACN of your customer's company but also check the exact spelling of the entity name. Sometimes, illegal Phoenix companies will set up the new company with one letter or number different to confuse suppliers and creditors, or in an attempt to go unnoticed that their trading entity is different to the entity that is inserted on supply contracts;

4. Know that a trading name is not a separate legal entity that can legally be pursued. Two entities for example, can trade under the one trading name and that is why it is essential to ask for the ACN and correct spelling of the company name. This makes it easy for Phoenix directors to simply change trading names or use the same trading name but create a different trading company.

What are the consequences for directors of an Illegal Phoenix Company?

Under the *Corporations Act (Cth) 2001* ("the Act"), directors have multiple duties which they must comply with, otherwise they may not only be in breach of the Act, but also place themselves in a position of personally or criminal liability for an act committed in the name of the company. Illegal Phoenix activity is one of those acts for which a director can incur serious penalties. ASIC outlines the following penalties which a director can incur if they are found to engage in illegal Phoenix activity:

- be found guilty of a criminal offence with a penalty of up to a maximum of $200,000, or imprisonment for up to five years, or both;
- have contravened a civil penalty provision (and the court may order you to pay to the Commonwealth up to $200,000);
- be personally liable to compensate the company or others for any loss or damage they suffer; and/or
- disqualifying a director from managing a company.

What to do if you suspect you are dealing with an Illegal Phoenix company?

ASIC and the Australian Taxation Office are the Australian authorities that most closely monitor illegal phoenix activity and deal with complaints, allegations and reports of illegal phoenix activity, though there are various other government entities which also assist. If you are a creditor of a company and suspect a company you are dealing with is involved in illegal phoenix activity, the first step you can do is report the company to ASIC. JHK Legal can assist with compiling a complaint and report on your behalf.

Separately, if you are aware that a company you have dealt with has gone into liquidation and are aware that the same directors have established a new trading entity with the same assets but without good value having been paid to the former company for those assets, then you can simply report the conduct to the former company's liquidator. The liquidator will be obligated to conduct investigations and compile a statutory report to ASIC. ASIC will then take steps to investigate the complaint and take the relevant enforcement action, which may result in the consequences outlined above.

JHK Legal has extensive knowledge on insolvency and debt recovery processes. We not only assist those who may be creditors or victims of illegal phoenix activity, but if you, as a director, are aware of your company having financial difficulties and are unsure of your director's duties and responsibilities in relation to your company's debts, we can assist with providing corporate advice as to options for your business's structure, including financial options that will avoid any possibilities of breaching your director's duties.