Rising from the ashes

BRETT MARTELLI AND LISA DOUGLAS, HEANEY & PARTNERS

READERS WITH YOUNGER children might remember the following scene from *Harry Potter.* Harry is in the headmaster's office and he gazes at a bird about the size of a large eagle with magnificent red feathers.

Harry smiles at the creature. Suddenly, it catches fire and burns to ashes within a few seconds. The headmaster explains:

"… Fawkes is a phoenix Harry. Phoenixes burst into flame when it is time for them to die and are reborn from the ashes. Ah, fascinating creatures the phoenixes …"

The contrast between the mythological phoenix and phoenix companies could not be greater. Harry's phoenix went on to achieve great things. In sharp contrast, although a phoenix arrangement may be legitimate they are often far less heroic.

A phoenix company rises from the ashes of an old, failed company. It has the same or a similar name, typically carries on the same business and has the same look and feel as the old company. Most importantly, however, the phoenix company has no liability for the old company's debts. The creditors of the failed company are left claiming or proving against an entity where the likelihood is that there will be no recovery.

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The legal stuff

In summary, under the Companies Act 1993 (the Act) a phoenix company is a company that at any time before or up to five years after the commencement of liquidation proceedings is known by a name which is a pre-liquidation name of the failed company, or a name that is as similar to a pre-liquidation name of a failed company as to suggest an association with that company.

A director of an insolvent company cannot, for a period of five years after the commencement of the liquidation be a director of a phoenix company, promote, form or manage a phoenix company (directly or indirectly) or carry on business in the same name as the failed company (directly or indirectly).

There are a narrow range of exceptions to this, the most important of which is where the phoenix company has purchased the business from the liquidator or receiver and the creditors are notified of this by the directors. Provided that this notice is given in accordance with the phoenix company provisions, the directors are entitled to take this course of action.

Serious criminal and civil penalties are in place for breaches of the phoenix company provisions. These range from directors being personally liable for all of the debts of the phoenix company through to fines of up to $200,000 and imprisonment.

What does this mean?

Providing the rules are adhered to, the provisions provide some protection to creditors by preventing phoenix companies being set up by directors of failed companies. However, when the rules are abused, contractors and suppliers could find themselves dealing with a company unaware that it is a resurrection of a previously failed company. Also important to note is that the rules do not prevent a director of a failed company from setting up a company with an entirely different name.

Prudent practice

There have been relatively few prosecutions since the phoenix company provisions were introduced in 2007.

Whilst this may suggest that the legislation has been an effective deterrent, it seems more likely that many phoenix arrangements are flying under the radar and that abuses continue to occur.

It is a fact of the business world that companies do fail. There are remedies that can be pursued under the phoenix company provisions and other provisions under the Act.

Prevention is however always better than cure. It is therefore helpful to remind ourselves of the need to be vigilant when extending goodwill and credit, particularly to those not well known to us. There is no substitute for careful due diligence.

Taking some easy and practical steps will not eliminate, but may assist to minimise, the risk of being burnt.

Included among these are making it a practice to investigate the history of the company you are dealing with by reviewing director/shareholder and other company information held on the Companies Office website and obtaining creditors' reports are two simple and inexpensive steps. Also being cognisant of the amount of credit being extended. Where possible, ensure that terms of trade take security for any goods or services supplied and register the security on the Personal Property Securities Register. And never underestimate the benefits of making enquiries of your industry colleagues for the purposes of evaluating potential partners or clients.