

Directors owe duties to the company to act in the interests of the company in order to promote good governance. In relation to phoenix activities (that is, the fraudulent act of transferring assets of an indebted company into a new company) directors are likely to breach a number of their duties if they are found to be involved in these activities.



A. DIRECTOR'S DUTIES UNDER GENERAL LAW

Six main types of directors' duties could be identified under General Law or Common Law. They are as follows:

1. Duty to act bona fide (in good faith) in the interests of the company as a whole: Good faith contains both subjective and objective elements, in that a director must genuinely believe that they are acting in the company's best interests and must also in a way that an honest and reasonable director would act.¹
2. Duty to exercise powers for a proper purpose: Directors must exercise their corporate powers for the purposes for which they were granted the position of director.²
3. Duties of care and diligence: Directors have a duty to be informed on the financial affairs of their company and to make an informed and independent judgment on the decisions put to the directors and to place themselves in a position to guide the company and monitor its management.³
4. Duty not to fetter own future discretion: Directors must exercise active discretions and not improperly place constraints upon the exercise of their directorial discretions so as to ensure that they are not limited from acting in the best interests of the company.

5. Duty to avoid conflicts of interest: Directors must avoid conflicts of interest⁴ and disclose and manage conflicts if they arise. If a director must choose between favouring his or her own interests and the interests of the company, the director must usually choose the latter course.
6. Duty not to make secret profits: Directors have a duty to account to the company for any profit that he or she makes in connection with his or her office without the company's fully informed consent.⁵

B. DIRECTORS' DUTIES UNDER THE CORPORATIONS ACT 2001 (Cth)

The main legislative directors' duties are contained in the Corporations Act 2001 (Cth) and they are as follows:

Section 180(1): Directors must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise.

Reasonable person indicates an objective standard of care, consistent with the development of the equivalent fiduciary duty.⁶ Reasonable degree of care and diligence requires a balancing act of the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to company from the conduct in question.⁷

¹ Whitehouse v Carlton Hotel Pty Ltd (1987) 162 CLR 285.

² Ngurli v McCann (1953) 90 CLR 425.

³ AWA Ltd v Daniels (1992) 7 ACSR 759.

⁴ Chan v Zacharia (1984) 154 CLR 178.

⁵ Furs Ltd v Tomkies (1936) 54 CLR 583.

⁶ ASIC v Adler (2002) 168 FLR 253.

⁷ ASIC v Doyle (2001) 38 ACSR 606.



Section 180(2): The business judgment rule provides the director must:

1. Make their judgment in good faith for a proper purpose;
2. Not have a material personal interest in the subject matter of the judgment;
3. Inform themselves about the subject matter of the judgment to the extent that they reasonably believe to be appropriate; and
4. Rationally believe that the judgment is in the best interests of the corporation.

The business judgment rule is an overriding safe harbour to protect directors from personal liability for breaches of duty owed to the company. The director must satisfy these requirements in order to have been taken to have satisfied the statutory duty of care and diligence.

Business judgment is defined in Section 180(3) as any decision to take or not take action in respect of a matter relevant to the business operations of the corporation. The rule applies only to business judgments consciously made, and failures to act or omissions are not protected.

Section 181: Directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation and for a proper purpose. This means directors must exercise their powers bona fide for the benefit of the company.

Section 182: Directors must not improperly use their position to gain an advantage for themselves or someone else, or cause detriment to the corporation, regardless of whether the benefit or detriment actually occurs in fact.

Section 183: Directors must not improperly use the information obtained as a director of the company to gain an advantage for themselves or someone else, or cause detriment to the corporation, despite of what actually occurs in fact.

Section 191: Directors have a duty to disclose to other directors any material personal interest in matters that relate to the affairs of the company.

Section 588G: Directors have a duty to prevent insolvent trading of a company. Please refer to our article on "[Director's Duty to Prevent Insolvent Trading](#)".

C. PHOENIX ACTIVITIES

Illegal phoenix activity involves the intentional transfer of assets from an indebted company to a new company to avoid paying creditors, tax or employee entitlements, thereby the new company arises from the ashes of a failed predecessor. The directors leave the debts with the old company, often placing that company into administration or liquidation, leaving no assets to pay creditors. Figures put the cost of illegal phoenix activity to the Australian economy to be between \$2.85 billion to \$5.13 billion annually.⁸

The Australian Securities & Investments Commission defines phoenix activities as those when 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; and
- 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.⁹

The particular duties a director conducting phoenix activities is likely to contravene include the duty to act in good faith and the duties in relation to proper use of information and position.

Specific remedies available against directors who engage in phoenix activity include civil and criminal penalties under the Corporations Act, disqualification of rogue directors, and access by creditors to directors' personal assets and the prevention and recovery of asset transfers. However, most of these protections are remedial action conducted well after the damage has been done, providing little prevention or deterrence for directors from engaging in phoenix activity.

D. NEW LAWS TO COMBAT PHOENIX ACTIVITY

In February 2020, a new Bill was passed to give new powers to the Australian Securities & Investments Commission (ASIC), the Australian Taxation Office (ATO) and liquidators to deter illegal phoenix activity and to prosecute those engaged in such activities.

The [Treasury Laws Amendment \(Combating Illegal Phoenixing\) Act 2020](#) commenced from 17 February 2020 (Sections 1-4), 18 February 2020 (Schedules 1-2) and 1 April 2020 (Schedules 3-4).

⁸ 'The economic impact of potential illegal phoenix activity', PricewaterhouseCoopers, April 2018.

⁹ ASC research paper, Phoenix Companies and Insolvent Trading, No. 95/01 (July 1996).



The Act makes the following main changes:¹⁰

1. Introduces new phoenixing offences with civil penalties for those who facilitate or fail to prevent a company from making creditor-defeating dispositions (Schedule 1);
2. Gives liquidators the right to apply for Court orders to set aside phoenix activities;
3. Gives ASIC the power to make orders regarding phoenix activities;
4. Prevents directors of companies from backdating resignations (ie any late lodgements are considered to apply from the date the notice was received by ASIC) or ceasing to be a director if there are no other directors so that companies are not 'abandoned' (Schedule 2);
5. Authorises the Commissioner of Taxation to collect estimates of Goods and Services Tax (GST) liabilities and require company directors to be personally liable for these under some circumstances (Schedule 3); and
6. Authorises the Commissioner of Taxation to retain tax refunds if a taxpayer has failed to lodge a return (Schedule 4).

The duty to prevent creditor-defeating dispositions has also been included as part of directors' duties. Creditor-defeating dispositions is a new concept, which involves transferring company assets for less than the market price or the best value for the property. This has the effect of hindering the availability of these assets in the winding up of the company to be distributed to its creditors.

It applies if the company was insolvent and the transfer of assets took place within 12 months before the company was wound up; or if the company entered external administration within 12 months after the transaction.

The ATO has issued a [Practical Compliance Guideline](#) to explain how the Commissioner of Taxation will administer the changes under Schedule 3 of the Act regarding GST, Luxury Car Tax (LCT) and Wine Equalisation Tax (WET) estimates.

For more information on related matters, you may wish to read the following articles:

1. [Directors' Duty to Prevent Insolvent Trading](#): This may be of interest if you are a Director of a Company.
2. [Financial Reporting Requirements](#): This article discusses the financial reporting requirements of large proprietary companies and some small proprietary companies under the *Corporations Act 2001*(Cth).
3. [Tax Rates \(2018-2019 and beyond\)](#): Sets out Australian federal tax rates 2018-2019 and beyond. Income tax rates for individuals and companies; superannuation guarantee rate; and the goods & services tax rate are discussed.

Comasters can advise clients on the duties of directors and the crime of phoenix activities.

¹⁰ Law Society Journal, 'New laws passed to tackle illegal phoenix activity', Danny Adno, April 2020; Australian Institute of Company Directors, 'Combating Illegal Phoenixing Bill 2019 passed', 13 February 2020, <https://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-18-issue-2/combating-illegal-phoenixing-bill>.

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