

## **DEFEATING THE ROGUE TRADER**

Many businesses are structured so that the trading entity has little or no assets and the asset holding company licenses or leases the main elements such as the business premises, plant and equipment, the name and intellectual property to the trading company in order to conduct the business. If the trading entity faces financial difficulty it can be placed into liquidation or administration.

A new trading company then rises phoenix-like from the ashes of the collapsed trading company to continue trading as if nothing had happened using the same premises, plant and equipment, staff as before but under a new company name.

You will no doubt have come across some of these examples in your business life and if you have lost money have been frustrated as to why people are entitled to continue to trade relatively free from their prior financial commitments.

Since the introduction of Part 5.3A of the Corporation Act there has been some mis-use by companies in being placed into administration to defeat creditors in a phoenix-like manner. This is done by the company appointing an administrator and then arranging for friendly creditors to give the directors of the company proxies for voting at the creditors' meeting which then are controlled by the directors who arrange for a Deed of Company Arrangement to be entered into with only a small amount being returned to creditors and thus wiping the slate clean for the company to continue to trade without any major impact on the company or the directors of the company.

A further example of this exploitation of power is where there are two companies which have a claim against each other, the director of a Company A arranges for a Deed of Company Arrangement using proxies so that any claim by Company B is brought to an end while Company A maintains its own claim against Company B. Trading during administration does not guarantee that Company A is solvent but it does allow the phoenix Company A to avoid being sued while retaining its rights to sue Company B. This will have a devastating effect on Company B.

### **So what can be done?**

1. The Corporations Act provides for applications to be made to the Supreme Court for the removal of administrators and appointment of alternative administrators or liquidators. If a creditor suspects an abuse of the appointment of an administrator they may obtain orders for the removal of the administrator but require more than a suspicion of phoenix actions and each case will depend on its own facts.
2. Bring an application challenging the validity of the administrator's appointment on technical grounds such as the company constitution in not being correctly followed in the appointment of the administrator. Again, such an application would be based on the facts of each case but the Court could resolve the matter by making orders for the rectification of such defects without affecting the administration of the company.

3. The phoenix action may also be challenged under a commercial morality claim. In the case of *Casual Life Furniture International* the ATO sought to wind up the company which adopted a mode of operation to set up a company, not pay tax and then put it into liquidation and set up a new company which would continue trading. The Court granted the application for winding up "to prevent the *perpetration of further commercial immorality*".

Therefore if you suspect phoenix activity it is imperative that you make appropriate investigations and enquiries and act quickly in order to seek the appropriate relief.

#### **HOW TO PROTECT YOURSELF**

- a. Always do a credit reference check on credit account customers.
- b. Have Terms and Conditions of Trade signed.
- c. Have a Credit Account Application completed.
- d. Get the Directors to sign Guarantees and Indemnities.
- e. Check credit references.
- f. Do not continue to deal with customers who do not pay your accounts.

**For further details please contact Adrian Riccioni at Lilydale on 9739 7377 and Frank Lamari at Carlton on 9344 1700.**

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