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Phoenix Companies Personal Liability and Penalties for Directors

The new provisions of the Companies Act 1993 relating to phoenix companies may not have anything to do with Greek mythology or Harry Potter. However, directors who do not heed them may find that they need magical powers in order to avoid a hefty fine or imprisonment.

The Companies Act 1993 ("the Act") adopts what has been to date a colloquial metaphor, and refers to "phoenix companies". A phoenix company is a new company that, like the mythological bird, rises out of the ashes of a failed company and takes on the failed company's business. More precisely, the Act describes a phoenix company as being, in relation to a failed company, a company that at any time before or within five years after, the commencement of the liquidation of a failed company, is known by a name that is also a pre-liquidation name of the failed company, or is a similar name. When phoenix company arrangements are put in place whereby a new company is created that has a similar name, similar management structure and similar assets to a failed company, the object is usually part of a scheme either to defeat creditors of the failed company or to mislead the public into believing they are dealing with the same entity as previously, possibly as part of an attempt to mislead creditors of the previous company.

Phoenix company arrangements have therefore been reviewed as part of recent insolvency law reforms and new penalties

and personal liability for directors and managers of phoenix companies came into force on 1 November 2007.

New Penalties

Under the new phoenix company provisions, a director of a failed company must not: for a period of five years after the date of commencement of liquidation of the failed company, –

a. be a director of a phoenix company; or

b. directly or indirectly be concerned in or take part in the promotion, formation, or management of a phoenix company; or

c. directly or indirectly be concerned in or take part in the carrying on of a business that has the same name as the failed company's pre-liquidation name or a similar name.

Note that subsection (b) is effectively an anti-evasion provision, which will prevent the director of a failed company nominating a partner, spouse or any other related person as a director of the phoenix company in an attempt to avoid these provisions. Note also that subsection (c) relates to a "business" rather than to just a company, and therefore a director of a failed company cannot work as a sole trader or in a partnership using the name of the failed company for business purposes.

"Any person who contravenes the above section commits an offence and is liable on conviction to a fine of up to $200,000 or 5 years' imprisonment."

For the purposes of the phoenix company provisions a "failed company" means: A company that was placed in liquidation at a time when it was unable to pay its due debts.

A "pre-liquidation name" is: any name (including any trading name) of a failed company in the 12 months before the commencement of that company's liquidation.

The new phoenix company provisions do not prohibit phoenix company arrangements per se, but they impose serious penalties on any directors who contravene section 386A (above) and therefore they act as a powerful deterrent.

In addition to the criminal sanctions imposed, any person who commits an offence under these sections of the Companies Act 1993 is personally liable for all of the relevant debts of the phoenix company. This does not just apply to directors. A manager is also personally liable for all of the relevant debts of the phoenix company if in the management of the company, the manager acts or is willing to act on instructions given by a person who the manager knows is involved in a phoenix company arrangement in relation to the company.

Exceptions

There are exceptions whereby penalties will not be imposed and directors not held personally liable. These are:

- for companies that acquire the business of a failed company under a voluntary administration scheme; or
- if a director or manager applies to the Court for an exception within five working days after the commencement of the liquidation of the failed company; or
- the phoenix company is already in existence and has been known by a name or names that are the same or similar to the failed company's pre-liquidation name for not less than 12 months before liquidation commences and the phoenix company has not been dormant during those 12 months.

Comments

It has always been difficult and expensive for creditors to bring claims against failed companies. This is particularly disconcerting to creditors when it is apparent that a phoenix company arrangement is in place. The new phoenix company provisions do not make it any easier or any less expensive for those creditors who are frustrated by a phoenix company arrangement.

However, the intention of the new provisions is to create a powerful deterrent so that directors of failed companies will not enter into phoenix company arrangements at all. Given that these new provisions have only been in force since 1 November 2007 it is difficult at this stage to comment on their effectiveness. However, directors, managers and advisers of companies that are unable to pay their debts as they fall due and may be facing the possibility of liquidation will need to take these new phoenix company provisions into account when considering any restructure of the failing business. While a phoenix company arrangement may resurrect the failed company in the short-term, there is now a risk of personal liability for those directors or managers involved.

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