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Restructuring & Insolvency
Australia

Safe Harbour Reforms

Overview

The safe harbour reforms are a relative newcomer to the high seas of Australian corporations law. Commencing in September 2017 the reforms have the stated aim of encouraging entrepreneurship, and avoiding the stigma associated with insolvent trading.

The "safe harbour" is not a new or separate species of corporate insolvency regime: it is a carve out from a director's duty to avoid insolvent trading and the potential personal liability of the director if she or he fails to do so. It is not a defence more widely in respect of other breaches of duties or statutory obligations of directors, and directors wanting to enter the safe harbour need to be mindful of complying with those other duties and obligations.

What a director wanting to enter the safe harbour must do

Directors in Australia have long had a statutory duty to prevent insolvent trading. The duty is engaged where:

- a person is a director at the time a company incurs a debt;
- the company is insolvent at that time, or becomes insolvent as a result of incurring that debt;
- there are reasonable grounds for suspecting that insolvency; and
- either:
  - the director is aware at that time of those grounds for suspecting insolvency; or
  - a person in the position of the director in the circumstances of the company would have been aware of those grounds for suspecting insolvency.

Safe harbour looks at the actions taken by a particular director to develop and put into effect a plan at the time when a debt is incurred. The core requirements set by the *Corporations Act 2001* (Cth)[1] in order for a director to have the benefit of the safe harbour are:

- the director starts to suspect that the company may become or be insolvent;
- the director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company; and
- the debt is incurred directly or indirectly in connection with any such course of action.

1 Sections 588GA and 588GB

The "better outcome for the company" is one that is better for the company than the immediate appointment of an administrator, or liquidator, of the company. Merely hoping for a better outcome is not enough - there needs to be some demonstrable action to develop and then implement a plan. The prospect that the plan will lead to a better outcome must be more than fanciful or remote. The test though does not require proof that there is a better than 50% chance of the outcome being better.

The safe harbour provisions provide a list of matters to which regard may be had in considering whether a course of action is reasonably likely to lead to a better outcome for the company. To satisfy as many of these matters as possible, directors seeking to have the benefit of the safe harbour would prudently:

- inform themselves properly of the company's financial position;
- take appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts;
- take appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company;
- obtain advice from an appropriately qualified entity who was given sufficient information to give appropriate advice;
- develop and implement a plan for restructuring the company to improve its financial position.

The advisor chosen to assist needs to be appropriately qualified taking into account the particular problems facing the company, and the nature, size, complexity and financial position of the company. There is no particular required formal qualification for that person, but in the circumstances of a large complex business in financial difficulty, using legal and accounting advisors with experience in insolvency turnarounds is strongly recommended.

The safe harbour is entered from the time when the director starts to develop the required course of action. It applies in respect of debts which are incurred directly or indirectly in respect of that plan. Debts do not have to be solely associated with developing the plan or specific aspects of its implementation. Ordinary trading debts may also be protected.

A director will exit the safe harbour if the course of action is not followed within a "reasonable period", if that plan stops being followed, if that plan stops being reasonably likely to lead to a better outcome, or when a liquidator or administrator is appointed to the company.

What disqualifies a director from consideration for the safe harbour?

There are a number of obligations with which a company must be complying before its directors can rely on the safe harbour. The company:

- must pay the entitlements of its employees by the time they fall due (including wages, leave entitlements and superannuation); and
- file returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the *Income Tax Assessment Act 1997*).

If the company fails to do so, and those failures involve less than substantial compliance, or are one of two or more failures during the 12 months before the debt is incurred, then directors cannot rely on the safe harbour.

There are also statutory obligations on directors to provide information on the appointment of receivers, administrators and liquidators. Failure to provide that information as required in the time limits set for a response may stop a director relying on the safe harbour. It may also stop the director relying on the information or records ultimately supplied when the director tries to rely on the safe harbour to defend insolvent trading claims made by a liquidator.

Whilst there is an ability for a Court to make an order which avoids those consequences, directors should be mindful of these obligations and comply with them if they wish to rely on the safe harbour.

Implications for a party dealing with a company whose directors are seeking to invoke the safe harbour

There are no notification requirements to the world at large when directors are taking steps intended to be relied upon at a later time to show entry into the safe harbour. Continuous disclosure rules applicable to listed companies, and the risk of engaging in misleading or deceptive conduct, are not suspended by the safe harbour.

The ASX has amended its listing rules to expressly reference the safe harbour reform. While the ASX's view is that no express reference or announcement needs to the effect that the directors of the company are invoking the safe harbour, the company's financial circumstances and any plan it is implementing may of themselves may be matters in an appropriate case which would be expected to need to be disclosed.

A supplier or other contractual counterparty may nevertheless not know that the directors of the company have invoked the safe harbour.

Safe harbour carries with it the assumption that a director suspects that the company may become or be insolvent. Where the company does communicate that its directors are attempting to rely on safe harbour, there may remain good commercial reasons to want to continue to deal with it. However there are also legal risks associated with transactions entered at that time in the event of a subsequent formal insolvency of the company.

Suppliers and other contractual counterparties should consider seeking advice about the best ways to manage those risks if they know or suspect the directors of a company are wanting to use the safe harbour.

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