Sailing your company into *Safe Harbour*

The Safe Harbour regime has been in force since 19 September 2017 and has changed the landscape for Directors who may find themselves in the position of looking to save their distressed company or for an orderly winding up of the company without the fear of personal liability for insolvent trading hanging over them.

Whilst still in its infancy, general awareness and understanding of the provision still appears quite low yet if widely understood, could lead to some viable outcomes for companies that are in financial distress.

In this **Q&A and Case Study**, we hear from our Director for Projects & Finance, **Shaun McGushin** who explains to us the ins and outs of the regime. We also hear from **Pauline Vamos**, former Chair of a listed company, who provides some practical information about the regime and what her experience was like when working with Shaun recently, to implement Safe Harbour.

Q&A with Shaun McGushin, Director, Projects & Finance

Q: What is the Safe Harbour law?

A: The Safe Harbour regime was implemented by the Federal Government as part of a stated focus on promoting a culture of entrepreneurship and innovation in Australia and with an aim of striking a better balance between encouraging entrepreneurship and protecting creditors.

Under the Safe Harbour regime the Board of Directors of a company may, if they start to suspect that the company may become or be insolvent, go into Safe Harbour by developing one or more courses of action that are reasonably likely to lead to a better outcome for the company if they are pursued and implemented.

There are a number of non-exclusive factors that a Director can take into account when considering whether a course of action is "reasonably likely" to lead to a "better outcome". These include whether the Director:

(a) is properly informing himself or herself of the company's financial position;

(b) is taking 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;

(c) is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or

(d) is developing or implementing a plan for restructuring the company to improve its financial position.

A Board should look to implement and adhere to these factors as they will clearly assist in supporting the position that the company is in Safe Harbor at the relevant time.

There are also certain conditions that need to be complied with at the time any debt is incurred. These include the company being compliant with its employee entitlement and tax reporting obligations.

It should be noted that the Safe Harbour regime is to be the subject of an independent review after 2 years as to its impact and so there may be changes to the regime in the future.

COVID-19 trigger
It should be noted that the Federal Treasurer announced on 22 March 2020 a temporary change of 6 months to some laws in connection with insolvent trading and the liquidation of the companies in response to the current financial crisis caused by the COVID-19 pandemic. This has since been passed into law by the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth). This is stated to be part of a set of amendments to assist businesses keep their heads above water and are expected to remain in place for at least 6 months. The changes include removing Directors from any personal liability for trading while insolvent in relation to debts incurred in the course of ordinary business during the 6 month period (which period can be extended) but this does not include debts incurred and a Director's conduct was dishonest; this is still an offence. This is in addition to and does not affect the existing Safe Harbour regime.

Q: When would a company look to use Safe Harbour?
A: The Board or any Director should look to have the company enter the Safe Harbour as soon as they start to suspect the company may become insolvent and certainly no later than when they suspect the company is in fact insolvent. The rule for Directors here should be to err on the side of caution but at the same time they should act reasonably. In the normal case you would expect that the Board will have been considering the financial positon of the company for some period beforehand and if it was deteriorating to start to consider the course of action that needs to be implemented to rectify the position. As such you would expect that in most cases the insolvent trading risk is not something that is going to happen overnight so there should be some time for the Board or a Director to look to Safe Harbour.

If the Board puts the company into Safe Harbor sometime after they suspected the company was insolvent and the company was insolvent at the time, then clearly the Directors have exposed themselves to some liability for insolvent trading.

Q: What benefits can I achieve from using the Safe Harbour regime? What value can it add to my company?
A: The benefits of the Safe Harbour regime for the stakeholders are clearly two fold.

- First, for the Directors it allows the Board some time to undertake a restructure of the company to achieve the better outcome and remove the risk of insolvent trading whilst the company is in Safe Harbour.

- Secondly, for the company, the creditors and shareholders it allows the achievement of a better outcome, whether it be say restructuring to make the company viable in the longer term or preparing for an orderly insolvency. This should mean that all the stakeholders will be better off in the longer term by the company going into Safe Harbour.

In addition, Safe Harbour can be implemented in private. A company does not need to make public the fact that it is in Safe Harbour. The appointment of a receiver, administrator or liquidator is done publically and it

does have some detrimental effects – it can adversely impact the value of the company and in the case of an administration or receivership, its ability to carry on business profitability.

Q: Research shows that not many companies are using it. Why do you think this is the case?

A: That is an interesting question and I think that there may be primarily two possible answers here.

- First and as noted above, a company going into Safe Harbour is done privately and as such it is difficult to get any accurate figure as to the number of companies that may have taken advantage of it. I would think that there are a number of companies that are in, or have been in, Safe Harbour but we are unaware of it. Safe Harbour is not something that a company would broadcast or disclose and if the better outcome is achieved and the company survives as a result, then we may never know of it.

- Secondly I suspect that notwithstanding that the Safe Harbour regime has been with us for over two years, there will be a number of companies and their Boards who are not really aware of it or really appreciate what can be achieved by it or have taken advantage of it in time. For example if a company has a secured creditor and the company runs into difficulties, a secured creditor may wish to enforce its security to recover rather than agree to the company going into Safe Harbour. In addition, the Safe Harbour regime is still relatively new and it still needs to develop.

Obtaining appropriate advice

Safe Harbour may not be available if directors do not obtain the appropriate advice at the time. This may vary depending on the circumstances but the sooner the directors obtain appropriate advice, the better position the company and the Directors will be in to not only take advantage of Safe Harbour but to successfully restructure the company or prepare for an orderly liquidation as necessary.

How we can help

If you suspect your company is heading towards or in the midst of financial distress and would like to know more about the Safe Harbour provisions and whether they apply, contact **Shaun McGushin** for some practical advice and/or assistance with implementation on +61 2 8651 8700 or email smcgushin@ashstreet.com.au

Case Study | Applying the Safe Harbour Principle

Pauline Vamos engaged Ash St. Legal & Advisory recently to assist with a distressed company and applying the Safe Harbour regime. In this case study, we bring the regime to life and gain more insights from her as to what Boards and Directors need to be mindful of when considering going down this path.

What was the current situation for the company you were dealing with?

I have been involved with two companies moving into Safe Harbour. The first 'company A' was a software business where sales had long lead times and fixed costs were difficult to reduce due to service contracts for existing clients. As a result, we started to run out of cash.

The second company 'B' was subject to extreme regulatory and contagion risk. An ASIC review caused the business model to become uncommercial and an appearance in front a Royal Commission reduced the trust of policy holders and underwriters. Service and contractual obligations meant that reducing fixed costs including staff costs was difficult to do in a short timeframe.

What prompted you to use Safe Harbour?

In relation to company A, we had been looking at potential capital raising, merger partners or a buyer for some months as we could see from cash flow modelling that we could run out of cash within 12 months. When it became clear we would run out of cash more quickly, we moved into Safe Harbour so we could pursue the various alternatives within the protections afforded by the legislation.

In relation to company B, we moved into Safe Harbour after a significant spike in policy cancellations causing an equally significant claw back on commissions. Cash flow modeling showed an imminent financial cliff so we moved into Safe Harbour so we could negotiate with our stakeholders.

Was it difficult for you to convince the other Directors to use Safe Harbour?

There was no difficulty in convincing Directors in either case. A Board should know when a company is facing into financial difficulty. In each case we had been meeting at least weekly so Safe Harbour was a known option well before we struck the financial criteria to move into it.

What tips/traps would you give to someone looking to apply Safe Harbour?

When you move into Safe Harbour you press the fast-forward button, so things get very busy. It is very important to let the Chair of the Board negotiate the commercial options and strategies while the Chair of the Safe Harbour committee should be focused on compliance with the necessary obligations.

It is imperative that you have independent verification that you continue to comply with Safe Harbour requirements. This takes the pressure off all parties.

+61 2 8651 8700
Level 1 ▪ 25 King Street ▪ Sydney NSW 2000 Australia
ashstreet.com.au

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Do you think, based on what the legislation requires, that an in-house counsel could tackle?

It all depends on what strategies are being pursued and how complex they are. Each company will have different options and it will depend on the skill and experience of in-house counsel. The other thing to consider is there is time of the essence takes on whole new meaning. Many of the strategies need to be pursued with haste and discarded quickly if they are not a viable option. In-house counsel are generally very busy and during these times there are many HR and contractual issues to be addressed which can benefit from corporate knowledge.

Finally, in my view, in these circumstances, external third parties can be less emotional, more objective and of course – they carry professional insurance cover.

Was the outcome what you expected?

Yes in both cases but not without a lot of hard work, high levels of stress and many close calls. It is vital that the Board and its advisers check in with each other almost daily to ensure everyone is finding the resilience to see the strategy through to achieve the outcomes being aimed for.

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+61 2 8651 8700
Level 1 ▪ 25 King Street ▪ Sydney NSW 2000 Australia
ashstreet.com.au