



Shedding the light on Safe Harbour

The Safe Harbour provisions in the Corporations Act which came into force 19 September 2017 provide a safe harbour for company Directors from civil liability for insolvent trading where the directors start developing one or more courses of action that are reasonably likely to provide a better outcome for the company than an immediate liquidation or administration. The Safe Harbour provisions protects Directors from insolvent trading liability arising from debts incurred directly or indirectly in connection with any such course of action.

Safe Harbour protections

In short, the Safe Harbour provisions introduce a safe harbour for company directors from civil liability for insolvent trading where the directors start developing one or more courses of action that are reasonably likely to provide a better outcome for the company than an immediate liquidation or administration. Safe Harbour protects directors from insolvent trading liability arising from debts incurred directly or indirectly in connection with any such course of action. Safe Harbour provisions only protects a Director from liability under the civil penalty provision, and not where the Director has committed an offence because their conduct was dishonest.

A Director does not breach the insolvent trading provisions if after the director starts to suspect 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 incurs a debt in carrying out the course/s of action. Here, “better outcome” is defined as “an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company”.

A non-exclusive list of factors as to whether a course of action is “reasonably likely” to lead to a “better outcome” includes 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.

This exception to the insolvent trading prohibition therefore encourages companies to support and restructure their business rather than shutting up shop to avoid liability for insolvent trading.

We solve complex business problems

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



Liability of holding company

A holding company may also be liable where the holding company does not prevent its subsidiary incurring a debt while insolvent. However, safe harbour also applies in this scenario if the holding company has taken reasonable steps to ensure that the Safe Harbour provision applies to each of the directors and the debt of the subsidiary and the safe harbour does apply to each of the directors and to the debt.

Conditions of Safe Harbour

Safe Harbour is not available if, when the debt is incurred, the company:

- (a) is failing to pay employee entitlements or meeting tax reporting obligations;
- (b) that failure leads to less than substantial compliance, or is one of two or more failures by the company during the 12 month period ending when the debt is incurred; and
- (c) no order has been made by the Court to exempt the company if the failures were due to exceptional circumstances or it is in the interests of justice to make the order.

Safe Harbour may also not be available if the director fails to fulfil their statutory obligations to provide certain reports or provide books or information to the administrator, liquidator or court, although there are certain exceptions to this.

COVID-19 amendments

On 22 March 2020, the Federal Treasurer announced a temporary change to some laws in connection with insolvent trading and the liquidation of companies in response to the recent financial crisis caused by the COVID-19 pandemic as part of a set of amendments to assist businesses keep their heads above water. This came into law on 24 March 2020 by the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) which amended the Corporations Act to provide temporary relief from the insolvent trading provisions.

Directors of companies will be relieved for a period of 6 months from 25 March 2020 from personal liability for insolvent trading where the company incurs debts in the ordinary course of the company's business during that period. It is possible that this period may be extended if the Federal Government considers that it is prudent to do so.

A holding company may also be able to be covered by the temporary relief if it takes reasonable steps to ensure that the amended regime applies to the directors and the debt of the subsidiary and the safe harbour does in fact so apply.

The changes are only temporary and are in addition to, and do not affect, the existing Safe Harbour regime. A company may still nevertheless go into safe harbour under the existing regime and not be restricted by the 6 month period.

It should be noted that the temporary changes do not include debts incurred by dishonest conduct, which are still subject to criminal penalties.

We solve complex business problems

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

Issues for companies to consider

Directors should ensure that they and their companies are fully aware of the safe harbour provisions particularly in the current economic climate and that they would be in a position to take appropriate steps to take advantage of safe harbour in the event insolvency or potential insolvency of their companies becomes an issue.

Some steps that can be taken including now include:

- **Ensuring financial records and reporting obligations are up-to-date and accurate:** safe harbour won't be available unless your books and finances are in order. It is important to ensure your company is paying in full its employees' entitlements and is compliant with its tax reporting obligations.
- **Early identification of the issues during financial difficulties:** by identifying the issues early, directors are best placed to prevent an insolvency and to implement a restructure plan. Early identification allows directors to quickly address the issues before they become larger problems that could possibly be fatal to the company and cause issues for the directors.
- **Obtaining the appropriate advice:** Safe Harbour may not be available if directors do not obtain the appropriate advice in respect to it. This may vary depending upon the circumstances but the sooner the directors obtain appropriate advice, the better position the company and the directors will be to not only take advantage of the safe harbour but to restructure the company as necessary.
- **Formulating and then implementing a restructuring plan:** a feasible restructure plan is necessary to take full advantage of the safe harbour. It is also important that such a plan is clearly documented so that in case the plan it is not successful, there is clear evidence of the steps taken, the purpose and the intent of the directors.

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 to not only take advantage of Safe Harbour but to successfully restructure the company 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

Disclaimer: This information is effective 8 April 2020 and is subject to change, depending on Government directives and announcements. The information set out above is general guidance only and is not intended to be relied on as a substitute for legal advice. Liability limited by a scheme approved under Professional Standards Legislation.

[106521]

We solve complex business problems

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