FACT SHEET

Safe Harbour

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RECONSTRUCTION + INSOLVENCY
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What is Safe Harbour?

The "Safe Harbour" regime commenced on 18 September 2017, with the introduction of Section 588GA into the *Corporations Act, 2001 (Cth)* ('the Act'). The law is to "create a Safe Harbour for company directors from personal liability for insolvent trading if the Company is undertaking a restructure outside formal insolvency".

Section 588GA(1) of the Act excludes liability for insolvent trading under 588G of the Act if:

- At a particular time after a person starts to suspect a company may become or be insolvent, he / she starts developing one or more courses of action which are reasonably likely to lead to a better outcome for the company; and
- The debt is incurred in connection with that course of action and during a specified time period.

It is a hindsight test, in that the protection only comes into play if and when the company fails.

It then falls upon the liquidator to prove that the directors should not qualify for protection.

How does it start?

Directors are required to develop a Safe Harbour plan, when they start to suspect a company may be insolvent, ie. unable to pay its debts as and when they fall due.

Directors are required to develop a plan to reasonably achieve a better return to creditors than would be achieved from an immediate appointment of an external administrator.

They must implement, monitor and where necessary amend the plan to ensure that the course of action continues to be reasonably likely that the return to creditors may be a better outcome than from the appointment of an external administrator.

Directors' Obligations

Sections 588GA(2) and 588GA(4) of the Act provide an inclusive list of matters with which a director **must** actively comply, to satisfy the Safe Harbour test.

These include:

- The director is to properly inform himself or herself of the company's financial position;
- The director is taking appropriate steps to prevent misconduct that could adversely affect the company's ability to pay its debts;
- The director is taking appropriate steps to ensure the company is keeping appropriate financial records consistent with its size and nature;
- The director is obtaining appropriate advice from an appropriately qualified entity (e.g. an Insolvency Practitioner) who is given sufficient information to provide appropriate advice;
- The director is developing or implementing a plan for restructuring the company to improve its financial position;
- The director is to ensure employee obligations (including wages and superannuation) are paid when they fall due; and
- The director is to ensure tax reporting obligations, such as BAS and FBT returns are met.

The first five (5) bullet points are indicative, non-exhaustive factors to which regard may be had in determining whether a course of action is reasonably likely to lead to a "better outcome".

What is a Better Outcome?

There is no quantification in the legislation as to what is a better outcome other than in Section 588GA(7) of the Act which refers to an outcome better than a formal insolvency appointment.

The better outcome assessment may be based on factors such as:

- Expected dividend to creditors (from an appointment of an external administrator) compared to the outcome from a going concern;
- Retain jobs for employees and reduce redundancy costs;
- Secured creditors are better off; and
- Asset realisations compared to a forced sale scenario.

The protection from Safe Harbour only continues for as long as the course(s) of action are reasonably likely to lead to a better outcome. Continuous monitoring is critical.

Directors should set milestones within the plan. At each milestone, the directors and their advisors should assess whether the company continues to satisfy the better outcome test and if necessary refresh their plan and / or opinion.

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When will Safe Harbour not apply?

There are several exclusions from the defense, pursuant to Section 588GA(4) and (5) of the Act, which apply where, when the debt was incurred, the company was:

- Failing to pay employee entitlements when due, or lodge returns, etc, as required by taxation law, and that failure amounts to less than substantial compliance with the obligation and was one of two or more failures to do those matters during the 12 month period ending when the debt was incurred; and
- After the debt was incurred, and the company has failed, there was a substantial failure to provide information or reports to an external administrator.

What if I do not suspect that the Company may be insolvent? Do I still need to implement a Safe Harbour plan?

In uncertain economic times, the implementation of a Safe Harbour Plan is good corporate governance and an excellent risk mitigation tool.

It ensures that the Board of Directors are thinking about "what if" scenarios and ways to mitigate the risks. Risk mitigation may include, among others, restructuring the Company's operations in event of a serious downturn in business activity.

A Safe Harbour Plan ensures that the Board of Directors are fulfilling their fundamental duties to ensure that they are across the financial performance and position of the Company. As part of devising a Safe Harbour Plan, the Board may consider using this opportunity to "stress test" their budgets under various "what if" scenarios.

The Safe Harbour Plan is essentially a restructuring plan which gives the Board an opportunity to think about the possible scenarios that the Company may experience and how to find a way through them. As it is a restructuring plan, its aim is to achieve a better outcome than the immediate appointment of an external administrator.

Other

There is no requirement for any formal notice to creditors or ASIC, or in fact any other stake holder or interested party.

The "Plan" will vary from matter to matter, but must be:

- Flexible and consider various options;
- Measurable; and
- Able to be amended.

Conclusion

The Safe Harbour regime is an important measure which can help a director avoid personal liability from an insolvent trading claim, but it is only effective in the right circumstances. Directors must recognise the signs of financial distress early and be ready to engage in the Safe Harbour regime without delay.

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