

Safe harbour provisions for directors of troubled companies.

By Stephen Barnes



Safe harbour provisions of the Corporations Act have been in place for over a year however are not well understood or well utilised but are relevant to all companies that are struggling and considering a turnaround or facing an insolvency process.

About the Author:

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He has over 25 years advising clients from new business start-ups to publicly listed companies and not-for-profit organisations, and across a wide array of industries. He prides himself on quickly understanding the client's business and issues, and synthesising problems to develop pragmatic solutions. He is also the author of 'Run Your Business Better'.

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In September 2017 Australian insolvency law underwent one of the biggest reforms since the 1990s with the introduction of various legislation including safe harbour provisions in the Corporations Act. The legislation was aimed to foster a business culture of entrepreneurship and move away from an environment that penalises business failure.

The safe harbour provisions however have had only a limited impact with only a minimal use of the provisions. There are several reasons why this may be the case.

- The provisions only apply to companies, and not enterprises structures as sole traders. The majority of small businesses in Australia are not structured as companies which reduces the application of the safe harbour provisions.
- There are also certain conditions within the provisions that many struggling companies and their directors cannot meet to allow them to use the safe harbour provisions.
- It is hard work with minimal protection for directors, and therefore it is easier and safer for directors to hand the company to an administrator.
- Anecdotally the use of safe harbour provisions and turnaround advisors are frowned upon by seasoned insolvencies professionals and many turnaround advisors are considered dodgy at best and criminal enablers at worst.
- The perception of a lack of transparency for customers and creditors.

What is safe harbour?

Safe harbour is a defence under the Corporations Act that allows some relief against a Director's duty to prevent a company trading while insolvent. While bringing a claim against a director

For insolvent trading is both costly and rare, the insolvency duty has long been criticised a factor that has resulted in Directors putting a company in voluntary administration, when in fact there is a reasonable expectation of a better outcome. Safe harbour promotes directors taking reasonable steps to trade the company out of financial difficulty without concerns about personal liability, or unnecessarily effects to the potential value of the company by prematurely appointing a voluntary administrator. Safe harbour promotes a cultural change within the Boardroom to try and turn their company around.

How safe harbour works

Safe harbour is only available to directors who are closely monitoring and involved in the financial position of company and have: -

- Paid employee entitlement on time; and
- Have appropriate financial records and these are kept up-to-date; and
- Kept and maintained tax reporting records and obligations.

The directors also need to develop a course of action that is reasonably likely to lead to a better outcome.

The legislation does not define reasonably likely or better outcome, so it is generally considered that an objective assessment is needed of the course of action to determine if it is reasonably likely to lead to a better outcome. This is where an experienced turnaround adviser is important, as the subjective opinion of the directors is not sufficiently meritorious. Substantiation of the course of action through a turnaround plan assessed by the turnaround advisor as leading to a better outcome than entering voluntary administration is what I consider the start of entering a safe harbour. Reasonably likely is when the decision is made to use the safe harbour provisions and not in hindsight.

Better outcome is defined in the Corporations Act as an outcome that is better for the company than the immediate appointment of an administrator, or liquidator of the company.

Safe harbour starts when the decision is made and the development of a course of action starts. However, the safe harbour provisions end when





it is no longer reasonably likely that the course of action will lead to a better outcome. It also ends when the course of action is not followed.

Conditions to safe harbour provisions

During the period of safe harbour directors need to ensure: -

- Debts must be incurred directly or indirectly in connection with the proposed course of actions
- All employee entitlements are continued to be paid on time
- All tax reporting obligations must be complied with.

Safe harbour protection only protects a director from civil liability for insolvent trading, so directors must still comply with other legal obligations including the director's duties of acting in good faith and in the best interests of the company.

ASX listed company are still required to comply with continuous disclosure legislation and obligations.

How to get appropriate advice with safe harbour.

The safe harbour provisions do not state what or who is an 'appropriately qualified entity' to provide turnaround advice with the safe harbour provisions. The Turnaround Management Association view is an appropriately qualified entity has: -

- Expertise in operational, management, financial and legal aspects of restructuring
- Tertiary qualified in turnaround
- Demonstrable turnaround/restructuring experience
- Compliance with a code of ethics and professional development requirements of the person's relevant accrediting organisation.

A combination of professionals, including accountants, lawyers, bankers as well as specialised, accredited turnaround professional can constitute appropriately qualified.

So, before considering safe harbour, or before putting your company in voluntary administration, talk to a turnaround advisor, and know that using the safe harbour provisions will be hard. Directors also needs to ensure they: -

- Have the energy and desire to drive the turnaround
- Understand their obligations
- Understand the company's financial position
- Seek appropriately qualified advisors to advise them
- Put a plan in place and document decisions made
- Continually review the course of action to ensure it is reasonably likely that there will be a better outcome.