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Managing insolvency

In the AICD member survey released in June, 16 per cent of SMEs said the temporary relaxation of insolvent trading laws had influenced their decision to continue trading.

By Christie McGrath, AICD senior policy adviser

One of the first economic measures announced by the government in response to the COVID-19 crisis was six months' temporary relief for directors from personal liability for trading while insolvent. This temporary relief was designed to give directors the confidence to make urgent decisions regarding incurring debt and continue to trade through the crisis without pressure to enter into administration if potentially insolvent.

The relief has been extended beyond the initial six-month period, to 31 December. The move follows calls by the AICD for an extension in light of the ongoing economic uncertainty. The expiry of the relief coincides with the introduction of the government's significant insolvency reforms intended to support small business (see below); these are due to take effect from 1 January 2021.

Safe harbour protection

As the temporary relief comes to an end, directors facing insolvency should be aware of the safe harbour provisions that predated the temporary COVID-19 moratorium. Introduced in 2017, the safe harbour was intended by the government to drive cultural change among company directors by encouraging them to keep control of their company and take reasonable risks to facilitate the company's recovery.

Like the temporary relief, the safe harbour can be used by directors to buy time and allow the company to keep trading through the COVID-19 crisis instead of immediately tipping into voluntary administration. Directors who are concerned about potential solvency in 2021 should be considering whether they will be able to use the safe harbour provisions going forward.

How does it work?

Under section 588GA of the *Corporations Act 2001 (Cth)*, a director will not be liable for the company's insolvent trading where the director starts developing – and within a reasonable period – implements a course of action that is reasonably likely to lead to a better outcome for the company.

To benefit from the relief, directors must ensure their organisation has paid all employee entitlements, complied with tax reporting obligations and kept up-to-date records.

When assessing whether the course of action will lead to a better outcome, directors do not need to contemplate every eventuality and compare that to the appointment of an administrator or liquidator. However, they do need to take action based on the information that is available.

The legislation provides guidance for directors seeking to rely on the safe harbour, and suggested steps for directors to consider. These include:

- Undertaking a thorough assessment of the company's financial position.
- Preventing any kind of misconduct by officers and employees of the company, which may include assessing compliance and monitoring systems.
- Obtaining advice from an appropriately qualified adviser.
- Developing or implementing a plan for restructuring the company to improve its financial position.

Directors concerned about potential solvency in 2021 should be considering whether they will be able to use the safe harbour provisions going forward.

These factors are a guide, and it is critical that directors continue to monitor the performance of the company and the viability of the course of action adopted.

The safe harbour legislation recognises that not all restructuring attempts or turnarounds will succeed. However, should a director later be subject to an allegation of insolvent trading, they will need to show evidence of a reasonable possibility that their course of action would have led to a better outcome.

Crucially, the safe harbour is not a "free pass" for directors. *Corporations Act* duties continue to apply, including that of directors to exercise their powers in good faith with care and diligence in the best interests of the corporation. Notably, under the best interests duty, directors are required to take into account the interests of creditors where a company is insolvent or nearing insolvency.

For further information, access the AICD's Safe Harbour tool at bit.ly/3mXDwzv

Insolvency reforms support small business

On 24 September, the government announced significant reforms to Australia's insolvency regime for small business. Drawing on key features from the United States, the reforms are intended to help more small businesses restructure and survive the economic impact of COVID-19. Where a restructure is not possible, the reforms aim to provide access to a simplified winding-up process.

Key elements of the reforms, which will require legislative amendment, include:

- The introduction of a new debt restructuring process for incorporated businesses with liabilities of less than $1m.
- Moving from a rigid one-size-fits-all "creditor in possession" model to a more flexible "debtor in possession" model, which will allow eligible small businesses to restructure their existing debts while remaining in control of their business.
- A rapid 20-business-day period for the development of a restructuring plan by a small business restructuring practitioner, followed by 15 business days for creditors to vote on the plan.
- A new and simplified liquidation pathway for small businesses to allow faster and lower-cost liquidation.

The AICD and other stakeholders are examining what further insolvency reforms will be needed to encourage Australia's economic recovery, including the thresholds for imposing director liability. ■

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