



The 'safe harbour' reforms were introduced into the Corporations Act in late 2017 and provide directors with protection from personal liability for debts incurred whilst they undertake a course of action that is reasonably likely to lead to a 'better outcome' for the company, than an immediate appointment of an administrator or liquidator. It is designed to encourage directors of companies with an uncertain financial position to attempt a turnaround plan.

The reforms focus on the behaviour and actions being taken by a director at the time debts are being incurred. The reforms are designed to be easy for directors to access; but there are hurdles to clear. Set out below are the key points regarding which companies will be eligible to enter safe harbour, what action needs to be taken by directors, and the range of external help directors should engage with. The practical application of these reforms will, in all scenarios, require a proactive, documented and managed plan - 'hope' is not a strategy when it comes to a turnaround plan.

## Which directors have access to safe harbour?

The safe harbour is only open to directors acting honestly and diligently who have taken appropriate steps to ensure the company:

- provides for employee entitlements – i.e. superannuation must not be more than 3 months in arrears and payment of entitlements should occur when they fall due;
- keeps tax reporting obligations up to date – i.e. all tax lodgements must be no more than 3 months overdue (similar to the Director Penalty Notice regime). Emphasis is on reporting, not necessarily payment.

If eligible, actions expected to be demonstrated by a director in determining whether a course of action is reasonably likely to lead to a 'better outcome' include:

- taking steps to prevent misconduct by officers and employees of the company;
- taking steps to ensure appropriate financial records are maintained;
- obtaining "appropriate advice" – this concept is discussed further below;
- keeping themselves informed of a company's financial position; and
- development and implementation of a plan to restructure the company to improve its financial position.

## What does a safe harbour / turnaround process look like?

	1 Suspect insolvency	2 Assess availability of 'safe harbour'	3 Develop turnaround plan	4 Implement and monitor turnaround plan	5 Leave safe harbour
<b>Actions</b>	<ul style="list-style-type: none"> <li>▪ Conduct a review on company's solvency</li> <li>▪ Directors seek advice as required</li> <li>▪ Avoid incurring new debts</li> <li>▪ Document steps being taken</li> </ul>	<ul style="list-style-type: none"> <li>▪ Engage 'appropriately qualified entities'</li> <li>▪ Assess eligibility criteria</li> <li>▪ Consider standstill agreements</li> <li>▪ View formed on availability of safe harbour which is documented</li> </ul>	<ul style="list-style-type: none"> <li>▪ Enter into standstill agreements</li> <li>▪ Implement business stabilisation and cash management</li> <li>▪ Formulate turnaround plan - advisors to provide 'better outcome' opinion</li> <li>▪ Obtain stakeholder approval</li> </ul>	<ul style="list-style-type: none"> <li>▪ Regular meetings to monitor progress</li> <li>▪ Maintain financial records</li> <li>▪ Continue compliance with all directors' duties</li> <li>▪ Continue to satisfy tax reporting and employee entitlement obligations</li> <li>▪ Change course as required</li> </ul>	<ul style="list-style-type: none"> <li>▪ Assess whether company is solvent or whether formal insolvency appointment is required</li> <li>▪ Safe harbour protection ceases when the turnaround plan stops being likely to lead to a better outcome</li> </ul>
<b>Documentation</b>	<ul style="list-style-type: none"> <li>▪ Document assessment of financial status</li> </ul>	<ul style="list-style-type: none"> <li>▪ Document engagement of appropriately qualified entity</li> <li>▪ Document decision of safe harbour availability and board approval</li> </ul>	<ul style="list-style-type: none"> <li>▪ Document formal restructuring plan and 'better outcome' opinion</li> <li>▪ Document timetable and responsibilities</li> </ul>	<ul style="list-style-type: none"> <li>▪ Regular, minuted meetings</li> <li>▪ Update financial forecasts</li> <li>▪ Reporting to stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>▪ Remember, if it isn't documented then it did not happen</li> </ul>

Timing: The turnaround plan must be implemented within a reasonable period. The process may last from anywhere between 3 months to 5 years depending on size and complexity of the business.

## What is a 'better outcome'?

A better outcome is one where the company is reasonably likely to be better off than the immediate appointment of an administrator or liquidator. The safe harbour protection applies from the time the director starts to take a course of action after beginning to suspect that the company may become insolvent.

Safe harbour is not intended to be a mechanism for a company to trade past the point where it is viable. Once it becomes clear that the company cannot be viable in the long term, the 'better outcome' test will no longer be satisfied and the protection of safe harbour will cease.

## Who can provide 'appropriate advice'?

The range of parties directors are able to engage to provide advice to qualify for safe harbour protection is deliberately broad to accommodate the wide range of businesses and scenarios that may arise. For example, a mid-size business may only require advisors with an ability to assess solvency, prepare financial forecasts, and with operational expertise. Larger corporates may require C-suite executives with appropriate turnaround experience together with a team of restructuring experts such as lawyers, accountants and investment bankers.

In our view, general expectations of an appropriate advisor would include:

- In-depth restructuring, turnaround and operational management experience
- Ability to assess a company's solvency and financial position
- Expertise managing stakeholders and competing interests
- Robust forecasting skills
- An understanding of cash and working capital management
- Crisis management experience
- Ability to effectively document and implement turnaround plans
- Independent of all stakeholders
- Complies with a code of ethics from a regulatory body
- Has appropriate professional indemnity insurance

## Key takeaways

Directors should embrace the introduction of a safe harbour protection – managed correctly, the possibility of a greater number of positive outcomes are available for businesses of all sizes. The key challenge for directors remains early and proactive engagement when signs of distress are apparent so that appropriate steps are taken to activate the safe harbour provisions whilst a turnaround or business rescue is attempted. Initiation of the safe harbour protection is designed to be relatively easy with only a few steps required before the protection is enacted.

Directors should remember to:

- Ensure they remain eligible to enter safe harbour if ever needed, by:
  - ensuring superannuation payments are not overdue and providing for employee entitlements as appropriate;
  - submitting all tax lodgements on time (the focus is on reporting, not necessarily payment);
  - being proactive in understanding the company's financial position; and
  - not incurring new debts that knowingly can't be repaid – this remains a breach of a director's duties.
- Choose advisors carefully – even though a broad range of assistance is permitted, in our experience turnaround is ineffective unless suitably credentialed and specialised experts are involved.
- Document your decisions, plan and outcomes – if a plan is not documented, it will be difficult for a director to rely on safe harbour protection if subsequently challenged.

*McGrathNicol is a leading advisory firm and first choice service provider to blue chip corporates, financiers and regulators. We are the 2017 winners of the Client Choice Awards for "Most Consistent Excellence" and "Best Accounting Firm". Our dedicated advisory and turnaround professional team is one of the largest in Australia.*

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## Want to know more?



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