

Review of the insolvent trading safe harbour

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Consultation Process

Request for feedback and comments

Closing date for submissions: 01 October 2021

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The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Review of the insolvent trading safe harbour

Overview

In 2017, Parliament enacted the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act 2017*. The amendments introduced a safe harbour for company directors from personal liability for insolvent trading if the company is undertaking a restructure.

The aim of the safe harbour reforms is to promote a culture of entrepreneurship by providing breathing space for distressed businesses to facilitate restructuring their affairs and continuing to do business. The safe harbour encourages directors to seek advice earlier on how to restructure and save financially distressed, but viable companies, rather than entering into administration or liquidation prematurely to avoid personal liability.

As part of the 2021-22 Budget, the Government announced that it would commence an independent review into the insolvent trading safe harbour, to ensure that the safe harbour provisions remain fit for purpose and its benefits can extend to as many businesses as possible.

To support this commitment, an independent panel has been appointed to undertake the review. The review will take place for a three-month period, concluding in November 2021. Following the completion of the review, the review panel will provide a written report to the Government, as specified in the review's [terms of reference](#).

Background to the safe harbour reforms

Australia's insolvent trading laws impose a duty on company directors to prevent a company from trading while insolvent. Under section 588G of the *Corporations Act 2001* (the Corporations Act), a director of a company may be personally liable for debts incurred by the company if at the time the debt is incurred there are reasonable grounds to suspect that the company is insolvent. Breaching these provisions can result in civil and criminal penalties against the company's directors.

Prior to the passage of the reforms, it had been suggested that the threat of action under insolvent trading provisions was encouraging directors of distressed companies to resolve the companies enter formal administration, instead of pursuing other restructuring opportunities, even where continuation of the business outside formal administration may be more appropriate. In its 2015 report, 'Business Set-up, Transfer and Closure', the Productivity Commission noted that:

The threat of Australia's insolvent trading laws, combined with uncertainty over the precise moment of insolvency has long been identified as a driver behind companies entering voluntary administration, sometimes prematurely.

To address this, the Commission recommended that a safe harbour from insolvent trading liability be established, to allow directors to make decisions relating to the restructuring of the company without fear of personal liability. This would also enable directors to retain control of the company, rather than giving up control to an external administrator.

On 19 September 2017, following passage of the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act 2017*, reforms to establish the insolvent trading safe harbour came into effect.

Operation of the safe harbour defence to insolvent trading

At their core, the reforms provide directors with a safe harbour defence from the civil insolvent trading provisions of section 588G(2) of the Corporations Act.

When the safe harbour defence applies, directors will not be personally liable for debts incurred while the company was insolvent where it can be shown that they were developing or taking a course of action that at the time was reasonably likely to lead to a better outcome for the company than proceeding to immediate administration or liquidation.

The reforms acknowledge that a course of action that is reasonably likely to lead to a better outcome for the company may vary on a case-by-case basis. The provisions are deliberately flexible as to what constitutes a course of action. They identify a number of factors that could be considered in determining if such a course of action was taken. These include whether the company directors:

- kept themselves informed about the company's financial position
- had taken steps to prevent misconduct by officers and employees of the company that could adversely affect the company's ability to pay all its debts
- had taken appropriate steps to ensure the company maintained appropriate financial records
- obtained advice from an appropriately qualified adviser, and
- had been taking appropriate steps to develop or implement a plan to restructure the company to improve its financial position.

The flexibility embedded into the safe harbour provisions is designed to encourage its uptake, including among SMEs (who might not have the resources to meet more prescriptive requirements).

The safe harbour provisions include rules around when the safe harbour protection is available to directors. The safe harbour is not available if the company has failed, within the previous 12 months, to substantially comply with:

- its obligation to pay its employees (including their superannuation), and
- its tax reporting obligations.

The protections provided as part of the safe harbour defence do not extend beyond the civil liability set out in section 588G(2). Directors must continue to comply with all their other legal obligations, such as their director's duties, which is intended to protect against misuse. The safe harbour does not extend to criminal liability for insolvent trading, noting that this requires dishonest conduct by directors.

Assessing the impact of the safe harbour

Section 588HA of the Corporations Act requires that the Minister cause an independent review of the impact of the availability of the safe harbour, including on the conduct of directors, and the interests of creditors and employees.

When assessing their impact, it should be noted that the safe harbour provisions have only been in effect for a relatively short period. Also, the confidential nature of company restructuring that may have taken place under the safe harbour protection limits the availability of quantitative data, further emphasising the importance of stakeholder submissions to this process.

Noting these challenges, the review seeks feedback from stakeholders who may have experience in corporate distress and turnaround, including the degree to which they have engaged with the safe harbour reforms, both from an adviser and any potential subsequent administrator or liquidator point of view, and (for those involved in companies whose directors utilised the safe harbour defence) their experience engaging with the reforms in practice. The perspective of creditors and other stakeholders is also sought.

The overarching intent is to determine the effectiveness of the reforms, and whether they are fit for purpose in enabling company turnaround, and promoting a culture of entrepreneurship and innovation.

Questions for discussion

1. Are the safe harbour provisions working effectively?
2. What impact has the availability of the safe harbour had on the conduct of directors?
3. What impact has the availability of the safe harbour had on the interests of creditors and employees?
4. How has the safe harbour impacted on, or interacted with, the underlying prohibition on insolvent trading?
5. What was your experience with the COVID-19 insolvent trading moratorium, and has that impacted your view or experience of the safe harbour provisions?
6. Are you aware of any instances where safe harbour has been misused?
7. Are the pre-conditions to accessing safe harbour appropriate?
8. Does the law provide sufficient certainty to enable its effective use?
9. Is clarification required around the role of advisers, including who qualifies as advisers, and what is required of them?
10. Is there sufficient awareness of the safe harbour, including among small and medium enterprises?
11. In relation to potential qualified advisers, what barriers or conflicts (if any) limit your engagement with companies seeking safe harbour advice?
12. Are there any other accessibility issues impacting its use?
13. Are there any improvements or qualifications you would like to see made to the safe harbour provisions and/or the underlying prohibition on insolvent trading?