Safe harbour:

Extended protection for COVID-19 has ended

Safe harbour I & II

Insolvency is generally accepted as when a company is unable to pay its debts as and when they fall due. Directors may be at risk of personal liability where a company continues to incur further debt while insolvent.

Safe harbour I - In September 2017, the Federal Government introduced amendments to the law, providing '*safe harbour*' protections to directors who responsibly endeavour to restructure a distressed business. Provided certain conditions are met, directors can avoid personal liability if a restructure plan is ultimately unsuccessful and the company subsequently goes into liquidation. **This protection remains available.**

Safe harbour II - With the rapid escalation of the impacts of COVID-19, the Government expanded safe harbour relief by providing directors with protection from insolvent trading liability for debts incurred in the ordinary course of business from 25 March 2020. **This additional protection ended on 31 December 2020. Directors can no longer rely on Safe harbour II protection for debts incurred after 31 December 2020.**

Directors must now rely on the original safe harbour protection which is more onerous

Safe harbour II was a welcome, but temporary, initiative. We are now seeing that the disruption caused by COVID-19 is extending well beyond 31 December 2020.

Directors should now consider the broader framework of **Safe harbour I** as its provides for the development of a robust plan, measured against a '**better outcome test**' (compared to immediate insolvency), that is monitored through its implementation.

How Safe harbour works

Directors acting 'reasonably and honestly' may avoid personal liability for insolvent trading if they pursue a restructure that is reasonably likely to lead to a **better outcome** compared to an immediate administration or liquidation of the company.

In order to rely on safe harbour protection for debts incurred after 31 December 2020, directors need to ensure that the restructuring plan stays on track and, if subsequently tested, complies with the requirements of **Safe harbour I.**

The four key compliance elements are summarised below.

1. A formal restructuring plan should be developed and followed

The key areas the plan might address include:

- baseline performance
- restructuring options and solutions
- cash generation and management
- stakeholder management
- operational improvement
- working capital.

The plan should be benchmarked against a comparative insolvency assessment to establish if it is 'reasonably likely' to provide the company with a 'better outcome', and needs to be reassessed at key milestones.

2. Directors should remain proactively involved through implementation by:

- Keeping properly informed of the company's financial position throughout the plan's life cycle
- Taking appropriate steps to prevent misconduct
- Ensuring that adequate books and records are being maintained and kept readily available

3. Advice should be sought from an 'appropriately qualified entity'

While management is responsible for developing and implementing the restructuring plan, directors will benefit from an independent review and assessment of:

- underlying assumptions to forecast models
- whether threshold safe harbour requirements are being met
- whether the plan satisfies the **better outcome** test at different points in time.

4. There are certain obligations which **must** be met to remain in safe harbour

Throughout the implementation phase:

- Employee liabilities must be paid when they fall due
- Tax reporting must be complied with

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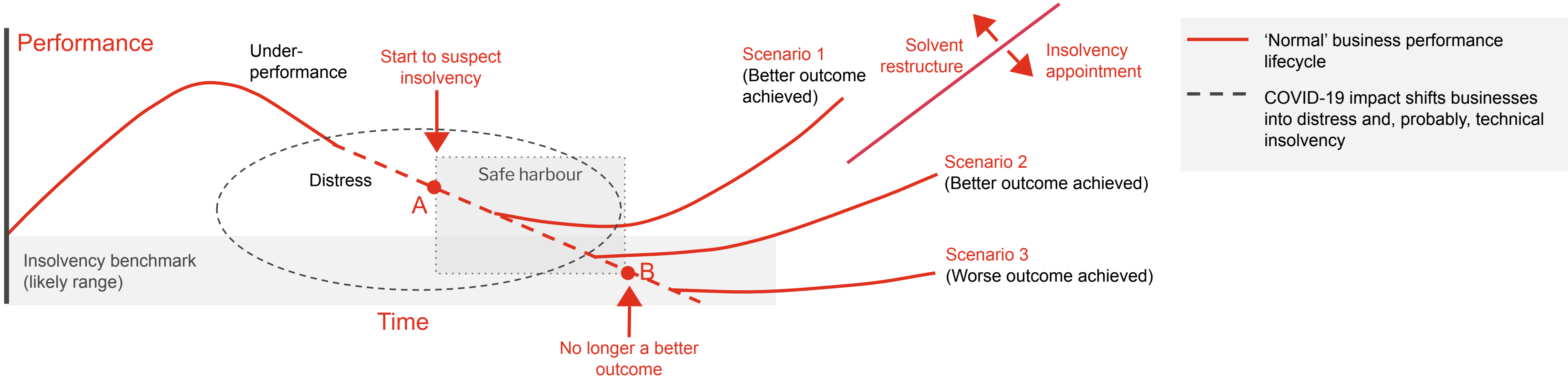
A point in time assessment of a better outcome



Scenarios for directors:

- **Pre-Safe harbour:** potential personal liability under Scenarios 2 & 3 from point A
- **Safe harbour I:** potential personal liability from point B Scenario 3, where the plan ceases to deliver a 'better outcome', but trading continues
- **Safe harbour mark II**: directors cannot be held personally liable for debts incurred between 25 March 2020 and 31 December 2020. **DOES NOT APPLY TO DEBTS INCURRED AFTER 31 DECEMBER 2020.**

Safe harbour I protection is based on a 'point in time' assessment, and extends for as long as the course of action remains reasonably likely to lead to a better outcome for the company and its stakeholders, and the threshold compliance criteria are met.

To be able to rely on the safe harbour defence, which will always be a retrospective review, directors should prepare and retain contemporaneous and sufficient evidence and documentation of their adherence to the safe harbour principles, including board meeting minutes, formalised restructuring plans, financial forecasts and the better outcome assessments undertaken at key milestones during the implementation phase.

Directors will not lose the protection of Safe harbour I, if implemented correctly, should the company ultimately fail. Where directors could become exposed to the risk of personal liability is if the trajectory of the plan no longer gives a better outcome (Scenario 3), but the company continues to trade and incur debt after this becomes apparent (point B).

Safe harbour II relief only applies to debts incurred in the nine month period to 31 December 2020. Unless the company is solvent at the end of the temporary relief period, to avoid exposure to personal liability, directors would need to place the company into administration at that point. To avert this suboptimal outcome, our view is that directors will be in a stronger position by activating **Safe harbour I** early in the process and using it as the framework for implementing a restructuring plan. **There is no relief from Safe harbour II for debts incurred after 31 December 2020. Directors must again avail themselves of the Safe harbour I protections which requires affirmative action by directors.**

Contact a specialist for a confidential discussion:

Michael Fung
Partner, PwC Australia
0407 788 634
michael.fung@pwc.com

Derrick Vickers
Partner, PwC Australia
0412 041 636
derrick.vickers@pwc.com

Melissa Humann
Director, PwC Australia
0419 851 697
melissa.humann@pwc.com