Bateman Battersby
LAWYERS

Making good choices when your business faces difficulties

Recent changes to the Corporations Act known as the "Safe Harbour Provisions" are aimed at making it easier for companies that are in distress to attempt to trade out of trouble. It's good news for business owners, if the new rules are applied sensibly.

Under Australia's existing insolvency laws, directors may be personally liable for debts incurred when their company traded while insolvent. Section 588G of the Corporations Act imposes a duty upon a director to prevent a company from engaging in insolvent trading where:

- he or she was a director of the company at the time the company incurred the debt;
- the company was insolvent at that time (or became insolvent by incurring that debt); and
- at that time, there were reasonable grounds for suspecting that the company was insolvent, or would become insolvent.

Section 588G was intended to discourage directors from allowing a company to incur debts which it would be unable to repay. However, it also had the effect of encouraging directors to prematurely place their company into the formal insolvency process, even in circumstances where the company could have been viable in the long term.

The new "Safe Harbour Provisions" changes, now give some protection to company directors, allowing them to continue trading in an attempt to rectify the company's problems. They provide that the duty to prevent insolvent trading will not apply if:

- The director, at a particular time after the director suspects insolvency, develops a course of action, which is reasonably likely to lead to a better outcome for the company than going into administration; and
- The company debt is incurred in connection with that course of action.

The directors do not have to follow a specific process in order to claim the safe harbour protection. The protection is dependent on the size and complexity of the company's circumstances. The new law does however include indicators about the need for the directors to do the following:

- inform themselves about the company's financial position;
- take steps to prevent misconduct by officers and employees;
- keep appropriate books and records;
- obtain advice from an "appropriately qualified entity, and
- develop and implement a plan for restructuring the company.

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The key test to be considered is whether course of action may be reasonably likely to lead to a better outcome for the company rather than going into administration or liquidation.

Another recent change to the Corporations Act that comes into effect from 1 July 2018 relates to a third party's contractual rights against a company that experiences an insolvency event (usually defined to include entering administration or having a receiver or liquidator appointed). Most commercial contracts contain a provision allowing a party to terminate the contract if the other party experiences an insolvency event (usually defined to include entering administration). The new legislation will suspend the exercise of that right of termination due solely to the occurrence of the insolvency event whilst the company is in administration or receivership. This will also help companies trade out of difficulty, by protecting their existing commercial agreements.

However, if the insolvent Company breaches other provisions of the contract, then the other party to the Contract may be able to rely on those breaches, rather than the insolvency, to terminate the contract.

If you need advice about your company or require further information on any of the matters addressed above, please contact Michael Battersby or John Bateman on 02 4731 5899 or email us at commercial@batemanbattersby.com.au.

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