KING&WOOD MALLESONS
金杜律师事务所

Tim Klineberg and Paul Schroder

Spotlight on: Safe Harbour

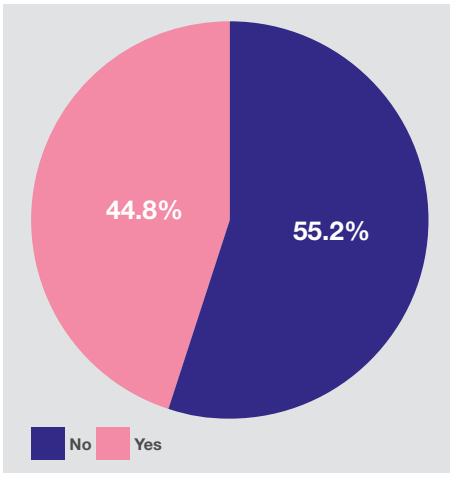
Have we seen change since the 2017 reforms?

The perception of Australia as being a relatively "risky" place to sit on a Board has generally focused on the insolvent trading prohibition in section 588G of the *Corporations Act 2001* (Cth) and how it interacts with general directors' duties.[1]

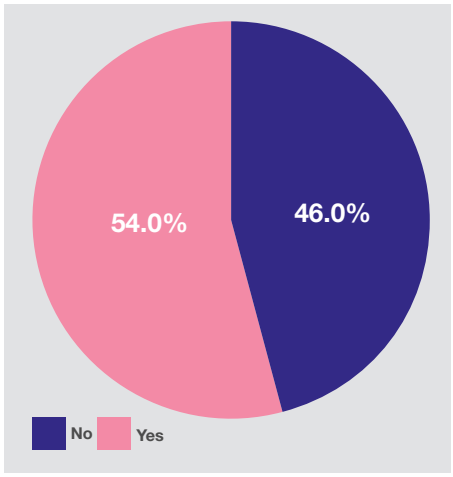
Prior to the introduction of the safe harbour reforms in September 2017[2], our previous *Directions* Survey tested the perceptions of Australian company directors on insolvent trading risk. Our questioning in 2015 focused on the impact of insolvent trading risk on directors' decision-making. Post safe harbour, our *2019 Directions* Survey posed similar questions.

In your role as a director, have you ever had to make a decision where you believed that the relevant organisation of which you were a director was in financial difficulty?

2016



2019



[1] The general directors' duties provided in sections 180 and following of the *Corporations Act 2001* (Cth) **(Corporations Act)** are also relevant to this perception. There are instances in the past where directors have been prosecuted for criminal breaches of directors' duties: For example, *R v Williams* [2005] NSWSC 315.

[2] *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth).

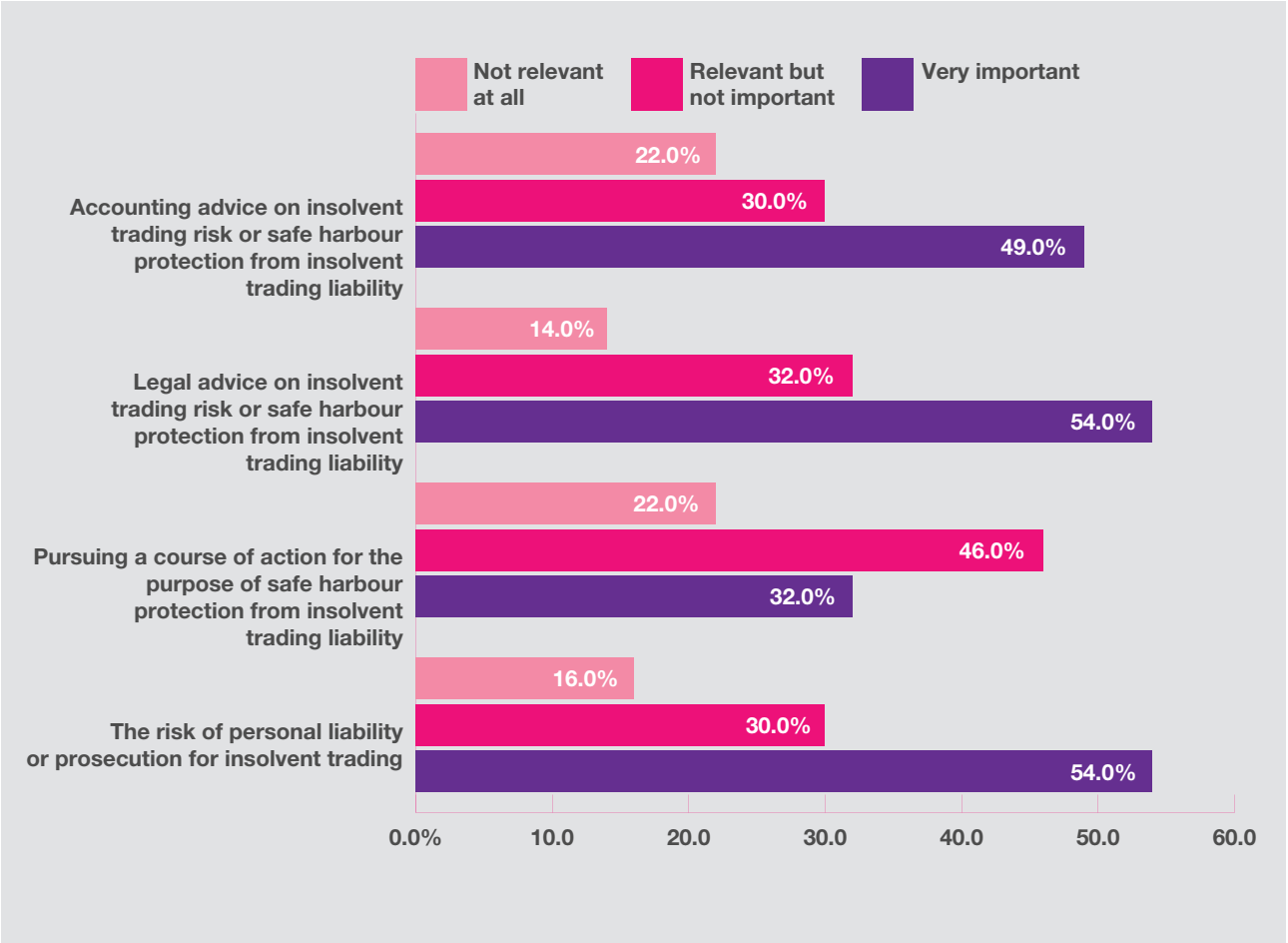
Tracking the change in attitides pre- and post- safe harbour has given us some interesting insights:

- Our data set included a greater proportion of directors of companies exposed to financial difficulties (54% from 45%)
- Those considering insolvent trading very important to decision-making increased (54.1% from 50%)
- Those considering insolvent trading not at all relevant, or relevant but not important to decision-making increased, but they remain a minority (16.2% from 10%)

The safe harbour provisions focus directors' attention on developing a course of action which is reasonably likely to achieve a better outcome than immediate administration or winding up.[3] Of survey respondents that have had to consider the issue:

- 78.3% indicated that pursuing a course of action for the purposes of safe harbour was very important or relevant, with 32.4% of those indicating it was very important.
- 86. 5% indicated that seeking legal advice on safe harbour was important or relevant, with 54.1% of those indicating it was very important.
- 78.3% indicated that seeking accounting advice on safe harbour was important or relevant, with 48.6% of those indicating it was very important.

When making a decision, which of the following factors were relevant or important to your decisions?



[3] Section 588GA(1), Corporations Act.

Yet two years into its implementation, are we seeing the safe harbour provisions achieve what they set out to do – encouraging innovation and informed risk-taking by directors? Secondary to this, yet fundamental to the discussion, is whether the safe harbour provisions are actually assisting directors of companies faced with financial distress?

The fact remains that nobody wants to be a defendant to an insolvent trading action. The safe harbour reforms have not changed that reality.

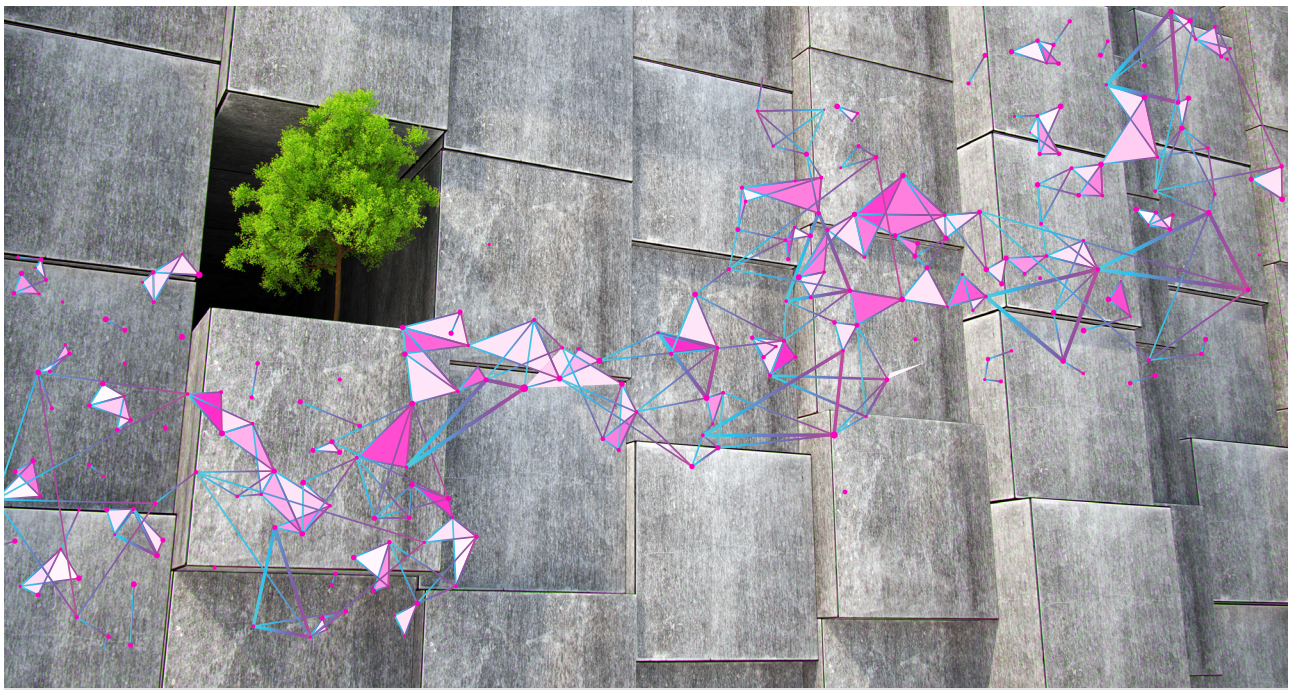
In our view, in the safe harbour era:

- It remains the case that the only true safe harbour for Australian company directors is the voluntary administration procedure. It is only once the directors' powers have been suspended and an independent insolvency practitioner has taken the reins as administrator, that the directors are truly "off risk".[4]
- With safe harbour, there is a better-defined pathway for directors who seek to limit their insolvent trading risk. We are seeing directors following that pathway. Whether this supports better outcomes for creditors will emerge over time. In theory, creditor outcomes should improve.
- Anecdotally, we have been engaged to advise on the "course of action" pathways that might be available, and on the prospects of those courses of action achieving their intended purposes. We have seen other advisers engaged to advise specifically on the "better outcome" test, including accounting firms with the relevant financial expertise.
- We have also seen examples where the safe harbour provisions have focused the attention of Boards on how value can be preserved outside of the administration procedure, pointing to the existance of genuine alternatives.
- In the administration context, we have seen safe harbour impact the recommendations of administrators in their reports and the recommendations to creditors. The fact is that insolvent trading recoveries will be even harder to pursue where directors have plausibly sought to follow safe harbour principles prior to administration.
- In the liquidation context, insolvent trading actions should now be harder for liquidators to prosecute. Safe harbour expands the options for directors to raise defences, and for them (or their insurers) to refuse to settle claims for significant sums.
- All of this is in a context where the safe harbour provisions have not yet been considered by the Courts. The next wave of insolvent trading cases will be important in confirming whether the reforms brought meaningful change in, and assistance to, the Boardroom.

For the time being, we consider that following the safe harbour pathway is now best practice for directors seeking to navigate financial difficulties.

Our view, based on our market research and advising in circumstances of financial distress, is that the safe harbour reforms have started to change the dialogue in the Boardroom and are encouraging restructuring-related activity outside of administration and liquidation. We expect this impact to continue and grow.

However, we have always regarded the law reform as slight, rather than fundamental. For that reason we are not surprised the change is likewise gradual. Fundamentally the safe harbour pathway allows directors to balance their competing concerns – the result will be that the outcomes will be better, as it is tested more and becomes better understood.



4 Section 588GA(1), Corporations Act.

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For assistance please contact: national.servicedesk@au.kwm.com

Media enquiries

James Bennett
Corporate Affairs Manager
T +61 3 9643 5338
M +61 476 009 133
james.bennett@au.kwm.com

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