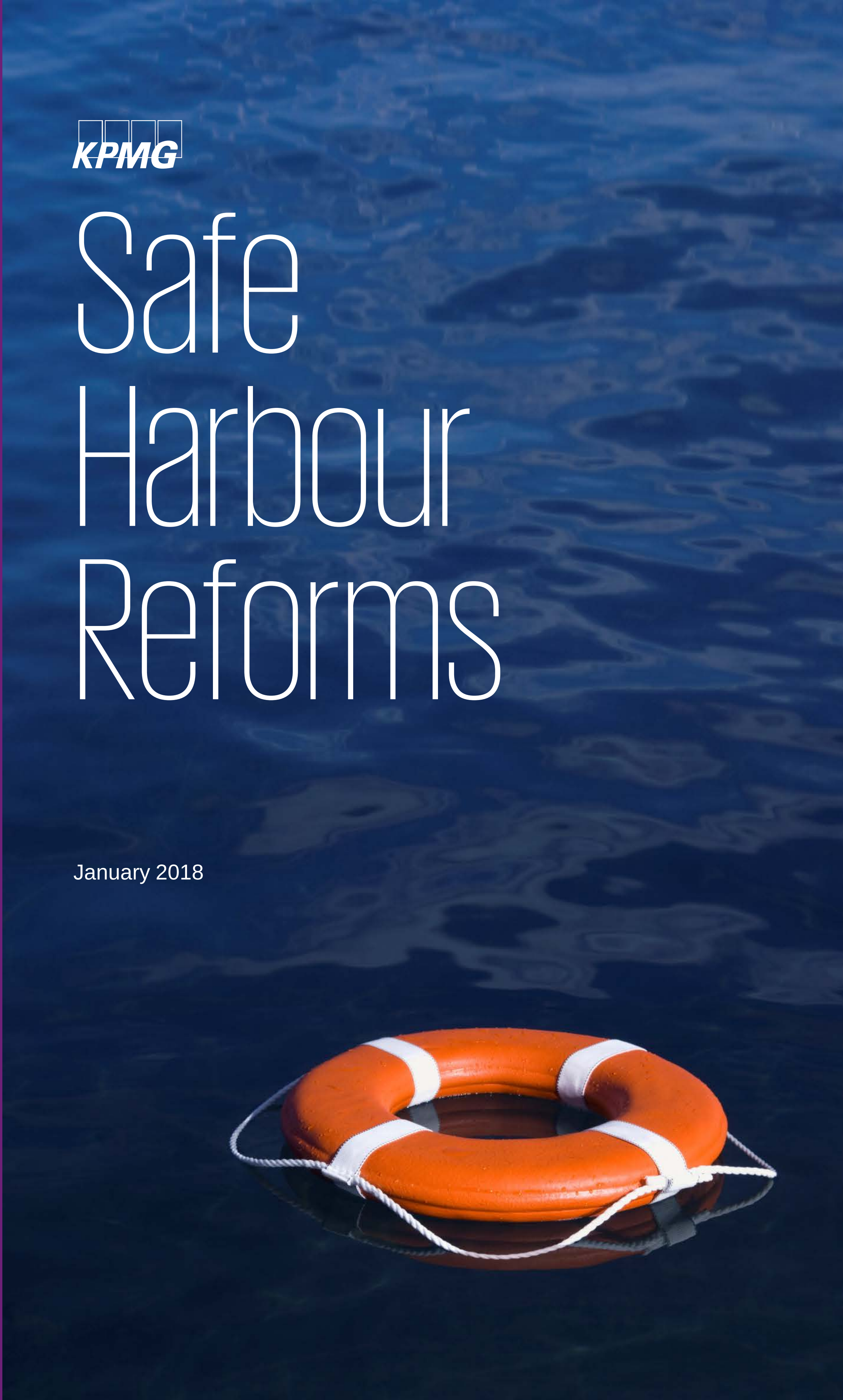

KPMG

Safe Harbour Reforms

January 2018

Overview

In September 2017 the Australian Government enacted legislation that greatly assists a company to effect a successful turnaround or financial restructuring during times of financial stress.

The new legislation is relevant to all companies and their directors who are considering any form of turnaround, financial restructuring or insolvency process.

It's now safer for Directors to restructure their companies

The ability of Australian directors to pursue potential company-saving strategies has historically been muted by Australia's strict insolvent trading laws, which compel directors to seek the appointment of a voluntary administrator when the threat of insolvency looms, in order to avoid the risk of personal liability.

In order to promote the prospect of Australian corporate restructuring new legislation has recently been enacted that:

a) creates a "safe harbour" for company directors from personal liability for insolvent trading if the company is undertaking a legitimate restructure outside of formal insolvency; and

b) will make certain "ipso facto" clauses which would allow the termination of a contract should an insolvency event occur, unenforceable.

"Entering the Harbour"

A number of conditions need to be satisfied in order to qualify for safe harbour protection, the most significant of which is that one or more courses of action needs to be **reasonably likely** to lead to a **better outcome** for the company (than the immediate appointment of an administrator or liquidator to the company).

Furthermore, the safe harbour is only open to directors who are closely monitoring the financial position of the business and who have taken appropriate steps to ensure the company has:

– paid entitlements of its employees by the time they fall due;

– kept appropriate financial records consistent with the size and nature of the company; and

– kept and maintained necessary tax reporting obligations – including returns, notices, statements, applications or other documents as required by taxation laws.

Through this, the amendments are intended to encourage honest, diligent and competent directors to 'enter the harbour' and remain in control of their companies to lead them to a 'better outcome'.

Key Terms

"Reasonably likely"

The legislation does not define what is 'reasonably likely'.

In our view, reasonably likely is a matter of substantiation whereby it is considered that there is more than a fanciful chance that one or more courses of action will lead to a better outcome than the immediate appointment of an administrator, or liquidator, of the company.

Whether the courses of action are reasonably likely to lead to a better outcome is assessed as at the time the decision is made, not with the benefit of hindsight.

A "Better outcome"

The Corporations Act has defined 'better outcome' as an outcome that is better for the company than the immediate appointment of an administrator, or liquidator of the company.

The safe harbour protection applies from the time the director starts to develop the courses of action that are reasonably likely to provide a better outcome for the company than an immediate liquidation or administration.

Safe harbour is not intended to be a mechanism for a company to trade past the point it is viable. Once the directors conclude that the course of action is no longer reasonably likely and therefore is not likely to deliver a better outcome than insolvency, the 'better outcome' test will no longer be satisfied and the protection of the harbour ceases.

“Docking in the Harbour”

If eligible for the Harbour, directors must continue to take an early and proactive approach to ensure that the courses of action are reasonably likely to lead to a better outcome. Such actions would include:

– engaging **appropriate advisors**;
– developing a turnaround plan, or plans;
– assessing whether debts are incurred directly or indirectly “in connection with the courses of action”;
– taking steps to address any employee misconduct;
– determining whether a standstill period can be agreed between internal and external stakeholders; and
– taking steps to maintain adequate financial records.

Appropriate advice

The legislation does not specify who is an “appropriately qualified entity”. In the Turnaround Management Association’s view, the general expectations of an appropriate advisor would include:

– expertise in the operational, management, financial and legal aspects of restructuring;
– tertiary qualifications in turnaround;
– demonstrable turnaround/restructuring experience; and
– compliance with the code of ethics and professional development requirements of the persons relevant accrediting organisation.

The KPMG Framework for Safe Harbour

	Suspect insolvency	Entering Safe harbour	Planning a better outcome	Implementation and Monitoring	Exiting Safe harbour
Objective	1 Preliminary assessment	2 Positive steps to develop a course of action	3 Course of action developed	4 Implement course of action and monitor performance	5 Assess success/ failure of course of action
Actions	1. Assess suspicions and review records, forecasts, employee liabilities and taxes 2. Undertake a **Rapid Safe Harbour Diagnostic** 3. Engage an expert 4. Plan and document steps taken 5. Engage with “other advisors”	1. Assess governance processes 2. Monitor financial reporting 3. Prepare a plan	1. Objective assessment of the company’s options 2. Roadmap of the actions timetable 3. Adoption of plan for internal and external stakeholders 4. Establish governance for execution of the plan 5. Validate upside scenario	1. Project manage the delivery of the plan 2. Report regularly to board 3. Ensure adequate governance is in place to manage challenges on the way	1. Assess whether the company is solvent or whether a formal insolvency appointment or solvency wind down is required
Evidence	• **Initial view of financial records** • **High level plan** • **Rapid Opportunity Diagnostic**	• Assessment of financial position • Governance program • View on safe harbour	• Better outcome assessment • Go/”No Go” assessment • Company resolution to implement • Quick Wins	• Progress reports • Steering committee meetings • Updated forecast financial model	• N/A
Time	The turnaround plan must be implemented within a **reasonable period**, having regard to the size and nature of the business.				

Source: TMA Best Practice Guidelines

Key takeaways

Whilst entering the harbour is a question of adherence to S588GA of the Corporations Act, undertaking a turnaround can be hard to do. Directors should ensure they:

– understand the company’s position;
– seek advice early from ‘appropriately qualified entities’;
– documenting decisions and plan outcomes; and
– continually review and re-assess any course/courses of action implemented.

Retaining the services of a Turnaround professional who not only understand the new laws but more importantly is practiced in Turnaround is key. KPMG’s Turnaround advisers are experts in helping companies during times of financial distress.

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