The Safe Harbour safety net

2019 has not started well. The Opal Tower debacle questions our confidence in bricks and mortar and the mooted changes to negative gearing and superannuation make navigating property and investments ever more challenging – and weigh heavily on anyone who either owns or aspires to own real estate.

This is particularly acute with small business, where access to finance is usually conditional on the bank securing the loan against the director's house.

When faced with cash-flow issues, directors often have no choice but to enter into repayment arrangements with the ATO, use other creditors by stretching out terms, sell surplus business assets, reduce overheads or streamline staff. However, this could lead them to unwittingly trade while insolvent as all of these actions are indicators of the company not being able to pay its debts as and when they fall due – meaning the company could be insolvent.

"Australia has some of the most draconian insolvent trading laws in the world," Jirsch Sutherland Partner and Safe Harbour specialist Ginette Muller says. "And the reality is, if you are a director and you take any of these actions, you may be about to commit an offence. But this is only applicable to directors of companies that end up in liquidation."

Claiming immunity from prosecution with Safe Harbour

Most directors are genuine in their attempts at repayment arrangements but Ginette says that entrepreneurs, by their very nature, tend to be optimists who don't think they are going to end up in liquidation.

"In my experience, nobody plans to go bust. Unfortunately, it isn't always that straightforward and sometimes one thing leads to another and before they know it, the unexpected happens and liquidation becomes inevitable," Ginette explains. "This is when you have to think back to the repayment arrangements and whether you might now be liable for insolvent trading."

Ginette Muller

Fortunately, there is a safety net for those facing this problem. The ‘Safe Harbour’ legislation is being progressively used by directors who need time to develop a solution that recognises that insolvency is fluid and while you are making honest attempts to steady the business, you should not be penalised down the track if your attempts ultimately fail. The Safe Harbour protection can be relied on if directors develop a course of action that is reasonably likely to lead to a better outcome for their company other than the immediate appointment of an administer or liquidator.

Ginette says she is starting to see Safe Harbour appear in more liquidations where directors are claiming immunity from prosecution and similarly are being exempted from paying compensation to the liquidator. “The whole process makes companies more resilient because to stay in Safe Harbour, directors need to be fully focused on their operations and across the details,” she says. “This has its own rewards.

“Obviously in the event of liquidation, the directors’ downside is covered because they will not be sued for insolvent trading or prosecuted for breaching directors’ duties. However, more importantly, they are now better governed and more aware of the risks that loom in their respective industries.”

Directors are advised to seek Safe Harbour protection prior to negotiating repayment terms.

“Safe Harbour protection is not expensive, as the director and senior staff remain in control,” Ginette adds. “There are rules they need to comply with to ensure they have a plan and are not driving themselves and creditors off a cliff. In exchange for their diligence, they can avoid the potential threat of insolvent trading. Safe Harbour is just another word for insurance.”