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feature

SOME PRACTICAL INSIGHTS ON SAFE HARBOUR

The potential to provide the greatest good for the greatest number.

As the two year anniversary of the safe harbour reforms arrives, Andrew McCabe and Joe Hayes of Wexted Advisors share some practical insights on the engagements they've conducted to date.

As well as demonstrating the better outcome test in practice, they outline their typical safe harbour engagement process and list some areas of uncertainty that the upcoming independent review is likely to focus on.

SAFE HARBOUR IN ACTION: ASX LISTED COMPANY

Here is one example of how the board of a listed company utilised the safe harbour law reforms to remain listed on the ASX and save jobs.

In mid-2018 the directors of an ASX listed company facing significant liquidity issues were considering voluntary administration or safe harbour. As Registered Liquidators and ARITA Members, we formed the view that we were an appropriate qualified entity to provide advice.

The likely outcomes of the two scenarios are detailed in Table 1.

Based on the courses of action implemented, as per the restructuring plan, the board successfully avoided formal insolvency by restructuring and recapitalising the business. The company continues to employ over 75 staff and remains listed on the ASX.

THE SAFE HARBOUR PROCESS

Based on our experience, we generally put a team of up to three staff on each safe harbour engagement. The work is undertaken in three key phases:

1. **Preliminary phase**
   Preliminary work to confirm eligibility criteria for Safe harbour protection. This generally takes up to one day to complete.
2. **Better outcome phase**
   The Safe harbour provisions are based upon the company adopting a corporate structuring plan (CSP) that addresses the requirements of the legislation and represents a better outcome than administration or liquidation. This phase generally takes 2–4 weeks to complete.
3. **Confirmation phase**
   The eligibility criteria and the courses of action need to be continually monitored and confirmed during the implementation of the CSP. The completion of the confirmation phase is subject to the length of the CSP.

REPORTING PROGRESS

Unlike the descriptive VA regime where the Insolvency Practice Rules of the Act (for example s 75-225) dictate when notices must be provided to creditors, and what must be included in the administrators report, the safe harbour provisions are less descriptive. The level of reporting and timing of providing reports during safe harbour are subjective to the views and interpretation of the appropriately qualified entity.

Usually there are multiple courses of action that make up a CSP. We have formed the view that in addition to issuing the initial safe harbour report, it may be appropriate to issue updated safe harbour reports on the completion of each key course of action. Each safe harbour report will retest the eligibility criteria and the better outcome test.

The CSP is dynamic and subject to economic factors. Accordingly, the CSP may be revised and adjusted from time to time. In the event the CSP materially changes from the original plan, then the eligibility criteria and better outcome test should be retested, and an updated safe harbour report issued.

COURSES OF ACTION

A summary of the courses of action taken on a selection of our engagements are shown in Table 2.

TABLE 1: LIKELY OUTCOMES OF TWO SCENARIOS FOR AN ASX LISTED COMPANY FACING SIGNIFICANT LIQUIDITY ISSUES

Liquidity issue	Voluntary administration	Safe harbour – better outcome
Suspicion of insolvency	Appoint a VA	Appoint a restructuring advisor
Director culture	Resignations	Additional layer of comfort allows directors to remain focused Facilitates new appointments
Funding	No funding	Maintenance of current & future funding
Goodwill	Eliminated	Retained
Employees	Redundancy	Retained (in full or in part)
Formal appointment	VA and possible receivership	Avoided
Notification	Public	Not required
Strategy	Without funding, wind down operations & dispose of assets	Operational pivot strategy Cost saving initiatives
Sale of assets	At forced sale value	Sale of non-core assets at market value
Creditors	No return to a partial return	Partial return to a full return
Shareholders	No equity return	Shares temporarily suspended Equity value maximised
Financial accounts	Incomplete	Signed as going concern
Litigation	Class action, insolvent trading claims, director breaches, auditor claims, preferential claims	Potentially avoided

TABLE 2: SUMMARY OF THE COURSES OF ACTION TAKEN ON A SELECTION OF OUR ENGAGEMENTS

Course of action	Project						
	A	B	C	D	E	F	G
Debt / Convertible notes	✓	✓	✓		✓		
Placement	✓						
Rights Issue	✓	✓					
Cost savings	✓	✓				✓	
Divestment of business	✓	✓		✓		✓	✓
Litigation / mediation to pursue claim			✓		✓		
Replaced director(s)	✓	✓		✓			✓
Jobs saved	+75	+20	+5	+50	+300	+20	+150

Safe harbour

NOTICE & IMPLICATIONS FOR STAKEHOLDERS

Directors have a duty to act in the interest of shareholders. However, where there is a suspicion of insolvency, directors have a duty to act in the interest of creditors.

In these circumstances, directors act in the best interest of creditors, and then shareholders, by the appointment of a restructuring advisor under the provisions of safe harbour. That is, the directors are continuing to fulfil their duties by firstly, seeking to maximise the repayment of creditors, and secondly, seeking to preserve equity value.

Directors fulfilling their statutory obligations and duties in the ordinary course of business, is not a notifiable event. Neither is the appointment of a restructuring advisor to assist the directors fulfil their statutory obligations and duties. For listed companies this is detailed in ASX Guidance Note 8, paragraph 173.

In our experience, there are occasions where directors have approved the disclosure of a restructuring advisor to a particular stakeholder in order to complete the CSP.

The possibility of successfully completing the CSP and restructuring the business is enhanced through the limited disclosure obligations on the company.

LESSONS LEARNT & OBSERVATIONS TO DATE

From our experience, we expect the upcoming independent review of the legislation to focus on a number of matters such as:

- the definition of 'appropriately qualified entity'
- independence
- eligibility – exceptions and court approval
- better outcome – reliance on third party reports, requirement to engage industry experts and valuations, retesting frequency and dates
- reporting of breaches of directors' duties
- remuneration.

We provide our views on these matters below:

- **The definition of appropriately qualified entity** – We believe that should an advisor be examined and questioned by counsel for a liquidator, the advisors will initially be questioned on their experience and credentials as a Registered Liquidator in order to undertake a better outcome assessment.

- **Perceived independence** – The clarification of the role for restructuring advisors under the safe harbour provisions or otherwise to provide pre-insolvency advice and later accept the appointment as an external administrator.

  A safe harbour advisor has a clear conflict of interest from taking an appointment as the voluntary administrator, deed administrator, or creditors voluntary liquidator, but not as a members voluntary liquidator. Whether the review extends to clarify the pre-insolvency advice (non-safe harbour), with the overlay of a special purpose liquidator to avoid any perceived conflict, will be a subject for the review.

- **Perceived independence may also be considered where** a company's accountant, or lawyer, provides the safe harbour advice; the audit firm provides the safe harbour advice; the extent of additional services provided by the safe harbour advisory firm; and the level of fees and dependency of payment of such fees on the better outcome analysis.

- **Eligibility** – Clarity on s 588GA(4)(b) of the Act around what is substantial compliance, and on s 588GA(6)(a) re what are exceptional circumstances.

  We recently had a position where tax reporting was lodged on time, although there was an error in the Business Activity Statement. The error was corrected as soon as it was identified. We believe the completion and lodgement of the BAS on time and in good faith was substantial compliance.

- **Notification** – The timing of future notifications, where contractually required. As the safe harbour law reforms become more generally accepted by stakeholders (e.g. financiers, insurers, noteholders and auditors), we expect that the appointment of restructuring advisors under the safe harbour provisions will become a notifiable event. New contracts will be worded to include such provisions (e.g. financing contracts, insurance renewals, director representation letters to auditors). A balance will need to be considered between notifying stakeholders and placing the success of the CSP at risk.

- **Better outcome analysis** – We believe, for our ASX listed clients, if the company remains listed we preserve the potential for shareholder returns. If there is sufficient equity for shareholders, then we assume all employees and creditors are repaid in full in the ordinary course of business.

- **Better outcome extent of analysis** – The assessment of the better outcome test against an immediate voluntary administration or liquidation. Clarification on the extent of the liquidation analysis, for example, whether a restructuring advisor needs to engage experts to value intellectual property or other assets, as part of the better outcome analysis.

  This may include non-income generating intellectual property, that is currently in the early stages of research and development or estimating mineral resources. Additional expert reports may add further costs to the safe harbour process, and may limit the number of companies that can afford to seek the protection afforded under safe harbour.

- **Better outcome testing date** – Clarification on the ongoing testing and assessment date at the engagement date, the completion of the key course of action, the successful completion of the CSP and/or the conclusion of the safe harbour advisor role.

- **Directors' duties** – As Registered Liquidators the need to consider reporting obligations of any breaches of directors' duties (or potentially breaches of one director). In consideration of the intent of the law reform, being the greatest good for the greatest number, it would seem unfair to report a breach of one director which triggers the early termination of the safe harbour law reform and liquidation of the company.

- **Restructuring advisor's remuneration** – the dependency and timing of the payment of fees will be reviewed. Receiving funds upfront in a trust account, is a solution where boards are willing to provide funds upfront.

- **Restructuring advisor's remuneration (during external administration)** – Confirmation with insurers that the D&O liability policy for insolvent trading cover will cover the reasonable fees and expenses of the restructuring advisor for any subsequent examinations undertaken by a liquidator. Also, that the payment of any such fees will not be based on a success fee, and not impact on the advisor's independence.

A POSITIVE FRAMEWORK FOR DIRECTORS

The safe harbour provisions provide a positive framework for directors to complete their statutory obligations and duties where there is a suspicion of insolvency.

In our view, safe harbour provides directors with additional time to seek professional advice and consider all viable options. It is this additional time that avoids the need for the immediate appointment of a voluntary administrator, enhances the likelihood of a successful turnaround, and provides a better outcome for stakeholders.

An ad from ARITA's 2018 safe harbour awareness advertising campaing.