Insolvent Trading - New Safe Harbour Provisions

There appears to be an unusual aspect of the new Safe Harbour provisions. That is, not only must the debt be incurred in the next six months 'in the usual course of business', but also an administrator or liquidator must be appointed during that six month period, not after.

Directors do not technically have a duty to prevent insolvent trading, but they will be liable if a company incurs debts when there are reasonable grounds to suspect insolvency.

To address the impact of the pandemic, Parliament has changed the law, but only for the next six months (although that period may be extended by regulation), to allow directors to continue to trade companies which may face insolvency. The temporary measures will expand the scope of the existing 'Safe Harbour' provisions in the *Corporations Act* which, until now, have not been well understood nor tested by the courts. Chapter 12 of the Explanatory Memorandum summarises the intent and purpose of the new provisions.

Both the old provisions (s588GA) and the new (s588GAAA) operate by providing directors with a defence to a claim of insolvent trading in contravention of s588G.

Under the old provisions, a director is protected, despite the fact that they may know or suspect that the company is insolvent, if they incur a debt in the course of taking a 'course of action' which is reasonably likely to lead to a better outcome for the company. That course of action can be developed in consultation with professional advisers.

The new provisions are, at first glance, much broader. There is no need for a director to have planned for a 'course of action'. It is only necessary to establish three elements to take advantage of the new protection.

Those three elements are:

- The debt was incurred 'in the ordinary course of the company's business': subsection 1(a);
- The debt was incurred during the temporary six month period (or, if a longer period is prescribed by regulation, that period): subsection 1(b); and
- The debt was incurred 'before any appointment during [the six month period] of an administrator, or liquidator, of the company': subsection 1(c).

Curiously, the third limb is not explained in the Explanatory Memorandum. Despite the ambiguous drafting, our view is that the protection of the new provisions is not available unless an administrator or liquidator is appointed during the six month period.

Directors, insolvency practitioners and businesses should be aware of this aspect of the new law – if debts are incurred during the six month period, but the company does not enter external administration during that six month period, then, in our view, the new provisions will not provide a defence to an insolvent trading claim.

Directors, insolvency practitioners and businesses need to be aware that, although the interpretation of the new provisions is not free from doubt, in this important respect the new provisions may afford a much narrower protection to directors than first appears.

The next six months will be extremely challenging for businesses and their professional advisers.

CCK Lawyers has the experience, capacity, know-how and depth to assist businesses in good times and in bad.

We Go the Extra Mile

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