COVID-19 –What Debt will Scuttle Passage to the New Safe Harbours?

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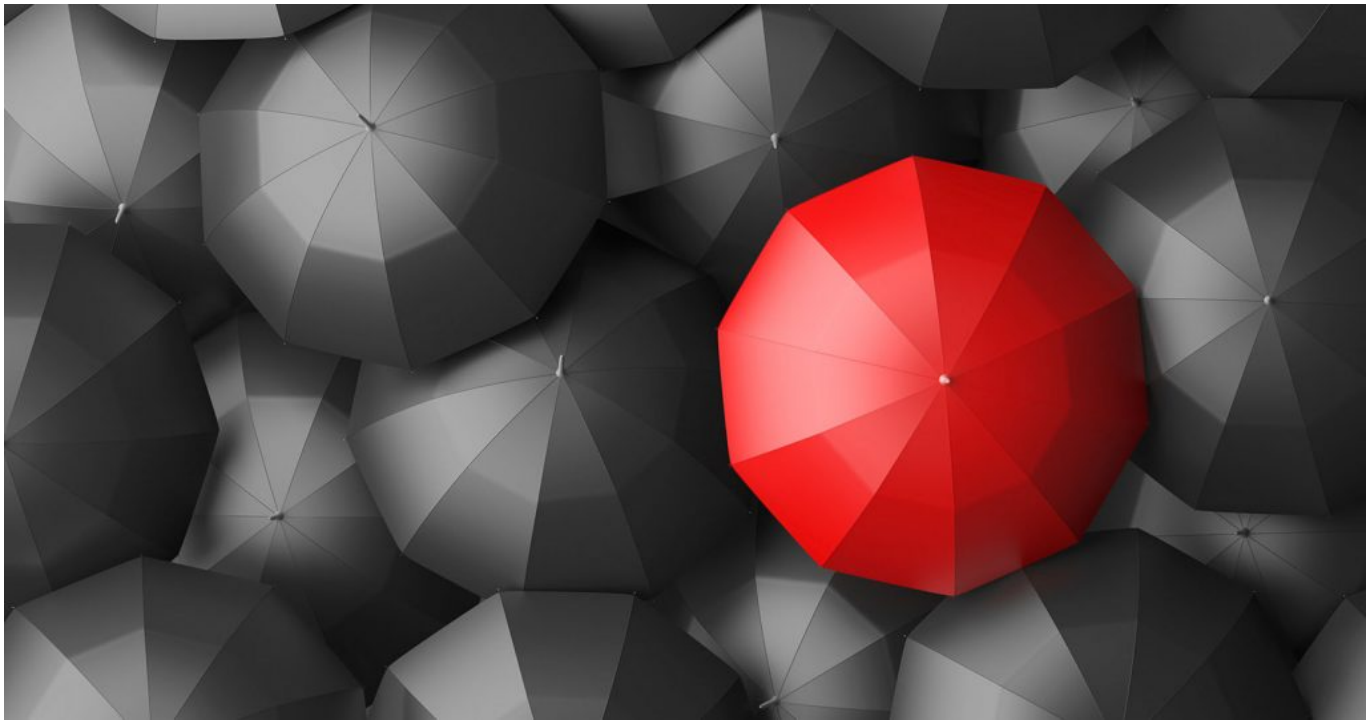

By Ellen Ferris, a Solicitor in Matthews Folbigg's Insolvency, Restructuring and Debt Recovery Group.

Amendments in March of this year have brought about changes to the Corporations Act 2001 which allow for an additional temporary safe harbour to protect directors from insolvent trading, - see our blog here.

However, companies do not automatically qualify for the protection. To qualify, the debt must be incurred as follows:

- In the ordinary course of the company's business;
- During the six month period starting from the date the new law commenced (being 24 March 2020); and
- Before any appointment of an administrator or liquidator.

The evidentiary burden of proof is on the person seeking to rely on the safe harbour relief, which means that it will be up to directors to make sure they obtain and keep evidence that their debt meets the criteria.

According to the explanatory memorandum in respect of the amending legislation, a director will be taken to have incurred a debt in the ordinary course of business if the debt "is necessary to

facilitate the continuation of the business during the six month period that begins on commencement of the subparagraph". This is narrower than the criteria for the existing safe harbour provisions, which focus on debts incurred in the pursuit of a course of action likely to lead to a better outcome for the company than liquidation. The Explanatory Memorandum gives the following examples for debts incurred in the ordinary course of business:

- Where a director takes out a loan to move some business operations online; or
- Where a business incurs debts through continuing to pay their employees.

As there are not many examples provided, this is an area of potential ambiguity which could lead to directors being unable or unwilling to take advantage of this protection. Case law does provide some guidance on the meaning of 'the ordinary course of business'. For example, the judgment of Rich J in *Downs Distributing Co Pty Ltd v Associate Blue Star Stores Pty Ltd (in Liq)* [1948] HCA 14 held at 476-7:

"It means that the transaction must fall into place as part of the undistinguished common flow of business done. That it should form part of the ordinary course of business as earned on, calling for no remark and arising out of no special or particular situation."

Similarly, Dixon CJ in *Taylor v White* (1964) 110 CLR 129 at 136 said:

"The time honoured phrase 'in the ordinary course of business' is meant to refer to transactions regularly taking place in a sustained course of activity or some usual process naturally passing without examination."

The term is therefore something to which directors and advisors must turn their mind before incurring debts during this period. Unfortunately, there is very little about business during COVID-19 which is ordinary. It may even be necessary in some circumstances for directors to use a combination of the existing safe harbour protections and the new, narrower protections created in response to the COVID-19 pandemic to properly weather this storm.

If you, or your client, are intending to rely on these safe harbour protections, it is important to consult an insolvency specialist. All of the solicitors on our Insolvency, Restructuring & Debt Recovery Team are members of the Australian Restructuring Insolvency & Turnaround Association (ARITA) and are experts in assisting in restructuring and insolvency related issues.

If you would like more information or advice on this area, please contact a Principal of Matthews Folbigg Insolvency, Restructuring & Debt Recovery Team:

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