Insolvency Law
Bulletin

When your safe harbour leads to a waterfall

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And the worst part is
Before it gets any better
We're headed for a cliff
And in the free fall I will realize
I'm better off when I hit the bottom

Paramore: Turn if Off

Everyone knows that once the federal government's subsidisation of businesses during the COVID-19 pandemic expires, a rush of insolvencies is looming. Unless action is taken to extend government support, many businesses will inevitably fail. However, many directors are not aware of another significant cliff (or waterfall, if you will) toward which they are already hurtling, if they have been relying upon the COVID-19 safe harbour introduced by the government to help keep business operating. In the absence of amendment or an extension of time to this section, all directors relying upon this provision **must** have appointed a liquidator or administrator on or before Thursday 24 September 2020, or stand exposed to an insolvent trading claim in respect of debts, even if they were incurred in the ordinary course of business.

The 6-month problem — the cliff you know about

In the great global rush to avert the fiscal iceberg, the government introduced a raft of legislative reforms in March 2020, which were intended to encourage businesses to continue operating as much as possible, and mitigate the potential exposure of those businesses to both financial and legal catastrophe should they do so.

All of those reforms were given a 6-month deadline so that there was some end date prescribed within which the world could emerge from its cocoon, and the drain on the economy and the government's coffers could abate. There was, in most cases, the ability of the government to extend many of the reforms, and of course Parliament would have this power in any event.

Whether and how the government acts towards the end of that 6 months in around September 2020 will determine how busy insolvency practitioners become.

… and the waterfall you might not know

However, in the rush to introduce protections for directors who were seeking to continue to conduct business (including incurring debts in the ordinary course of business), the government appears to have introduced a significant legal imperative **forcing** business into external administration before the end of the 6-month period.

Directors will have no choice but to place their companies into external administration on or before 24 September 2020 if they want to gain the protection of the COVID-19 safe harbour protection. If an appointment is made 1 day later — on Friday 25 September — the protection will be lost and the director will be exposed to a claim for insolvent trading for all debts incurred during the COVID-19 period.

COVID-19 safe harbour protection

The government's additional "safe harbour" for COVID-19 was introduced by inserting s 588GAAA into the Corporations Act 2001 (Cth) ("**the Act**"). However, this provision requires directors to have made an appointment by 25 September 2020 **in order to obtain the protection offered by this section**.

Relevantly s 588GAAA is as follows:

> **CORPORATIONS ACT 2001 — SECT 588GAAA**
> **Safe harbour — temporary relief in response to the coronavirus**
>
> (1) Safe harbour
> Subsection 588G(2) does not apply in relation to a person and a debt incurred by a company if the debt is incurred:
> (a) in the ordinary course of the company's business; and
> (b) during:
> (i) the 6-month period starting on the day this section commences; or
> (ii) any longer period that starts on the day this section commences and that is prescribed by the regulations for the purposes of this subparagraph; and
> (c) before any appointment during that period of an administrator, or liquidator, of the company.

The section was introduced by the Coronavirus Economic Response Package Omnibus Act 2020 ("**the CERPOA**"). The CERPOA received royal assent on and commenced on 25 March 2020. Six months starting on 25 March 2020 would expire on 24 September 2020, meaning the COVID-19 safe harbour will only apply to debts incurred between 25 March 2020 and 24 September 2020.

Safe harbour?

The government's intention was clear:

> There is a new temporary, six-month period in which a new safe harbour from the directors' duty to prevent insolvent trading applies. The new safe harbour provides temporary relief from personal liability for insolvent trading where it applies.[1]

It is clear enough that the intention of the section was to protect directors from being liable for insolvent trading in certain circumstances, namely where they have incurred a debt in the ordinary course of business, but not withstanding this, the company has ultimately been placed into external administration.

The section involves three requirements, in order for a debt incurred to be excluded from the operation of s 588G of the Act (and therefore, the exposure of the director to risk of breaching that section by incurring the debt):

- The debt must be incurred "in the ordinary course of the company's business";
- The debt must be incurred during the 6-month period (or any extension of the period);
- The debt must be incurred before the appointment of the administrator or liquidator (during those periods).

Ordinary course of business

It is a matter for discussion at another time as to what constitutes "the ordinary course of the company's business" when that business is seeking to trade its way through a global pandemic, and especially given the whole point of the section is to consider debts incurred by the company in the midst of that global pandemic.

On its face the wording appears to be practical and common-sense. However in circumstances where a business may need to informally restructure, make difficult decisions to buy substantial new equipment, or make investments and incur costs to avoid business failure, or taking radical steps which it might not otherwise have had to do, in order to avoid catastrophe, can it really be said to be to be in the "ordinary" course of the company's business?

The explanatory memorandum suggests that some of this extraordinary expenditure may be intended to be excluded from liability:

> A director is taken to incur a debt in the ordinary course of business if it is necessary to facilitate the continuation of the business during the six month period that begins on commencement of the subparagraph. This could include, for example, a director taking out a loan to move some business operations online.[2]

There is very little about 2020 and the COVID-19 pandemic which has been ordinary, and perhaps the court will apply a gloss on the section so that it is interpreted to mean the ordinary course of the company's business "in the middle of a global pandemic". However that is grist for another mill.

Help! My safe harbour has a waterfall in it!

The more obvious difficulty with the section is the requirement in s 588GAAA(1)(c) that any protection provided by the COVID-19 safe harbour will only be granted if an administrator or liquidator is appointed "**during that period**". Essentially that means that unless the 6-month period starting on the commencement date (that is 25 March 2020) is extended, then that period will expire on 25 September 2020.

In order for directors to obtain COVID-19 safe harbour protection under this section, appointment of an external administrator **must have occurred prior to 25 September 2020**.

It is not clear why this additional constraint was incorporated into the section. It might have been more readily understandable if the section simply carved out the debts which were incurred in the ordinary course of business during the COVID-19 period, regardless of when the company was ultimately placed into external administration. That way, if the Company was placed into administration in November 2020 (or 25 September 2020) the director would remain protected from pursuit of those debts incurred in the ordinary course of business during the coronavirus pandemic.

It may be that the intention of the government was to avoid a director being absolved from liability for debts incurred during the COVID-19 period, where the company was otherwise poorly conducted and which led to an administration a short time afterwards.

In any event, this is the effect of the wording in the section. That is, in the event an administrator is appointed on 25 September 2020, any protection which the directors might have had in respect of debts incurred entirely in the ordinary course of business during the COVID-19 period would be lost. The director will be exposed to a claim for insolvent trading and, in circumstances where the company had been placed into liquidation relatively shortly afterwards, the difference would be an interesting exercise to explore having regard to the company's financial position before, during, and immediately after the COVID-19 period.

Looked at the other way of course — directors incurring debts now, even in the ordinary course of business, need to be aware that they are **not** protected from liability for those debts under the COVID-19 safe harbour, if they choose not to appoint an external administrator by 24 September 2020. They will want to have a solid expectation that the company will be able to survive post the COVID-19 safe harbour sunset.

Of course if a director has a reasonable expectation of solvency, he or she will have a possible defence to insolvent trading under s 588H(2) of the Act. But that defence is available anyway — so what then would have been the point of the COVID-19 safe harbour?

Sunset over the waterfall

It may be that the government will extend the operation of s 588GAAA. By the time you are reading this the problem may have been fixed, or if the section's expiry date is simply extended then the problem will have simply been deferred — the waterfall moved further away.

Of course Parliament could amend s 588GAAA at any stage. In addition, the CERPOA contains its own extension power to defer the sunset of various provisions administratively. Schedule 16 of the CERPOA allows the relevant minister for any legislation to intervene, where "a provision of an Act or legislative instrument (the ***sunsetting legislation***) would … cease to have any operation on a day" (s 1(1) of Sch 16 of the CERPOA).

If s 588GAAA falls within this sunset deferral provision, the minister may extend the end date for up to 6 months — effectively creating a "***later sunset date***".

Does the deferral provision apply? Technically s 588GAAA does not stop to operate after 25 September 2020. The section will still be effective for debts already incurred, it will just become ineffective as regards debts incurred after the sunset date.

Section 1(4) of Sch 16 of the CERPOA may assist, however, providing "sunsetting legislation may cease to have any operation on a day because:

> …
> (b) any power, right or liability conferred, created or imposed by the sunsetting legislation ceases."

Does s 588GAAA create a "power, right or liability"? Certainly not a liability, and probably not a power. It may be that the section creates a right upon which directors are or would be entitled to rely to avoid personal liability for debts incurred in the ordinary course of business. On a stricter view, however, directors still retain that right in respect of debts incurred in the initial 6-month period so that sunset may be deferred by the Minister. Whether or not there will be any extension remains, of course, a matter of speculation.

I think you're gonna need a bigger boat

In the meantime, there will be a critical decision which all directors will need to make, if they have incurred debts since 25 March 2020, even if those debts where incurred entirely in the ordinary course of business. Does the director take the risk and delay appointment of an external administrator in the hope that the company will **never** be wound up, or is the safer course for all companies at any risk to appoint an external administrator on or before 24 September 2020, to ensure that protection is obtained under s 588GAAA, and the directors' boat remains in untroubled waters?

In addition, the transition between pre- and post-COVID-19 safe harbour provisions will be a bumpy one. As Mark Giddings pointed out in the last *Insolvency Law Bulletin,*[3] the courts have to date treated the COVID-19 amendments to the Corporations Act as anomalous, extraordinary amendments which should not be interpreted in light of the law as it was before. Giddings rightly points out that presumably this will also mean the law will "also interpret the effect of the amendments as coming to an abrupt end overnight."

As with everything else to do with this pandemic, directors are given a tough decision and will need to make that decision without a complete safety net, whilst also keeping an eye on any possible legislative amendments.

For insolvency practitioners, of course, this quirk in the operation of the COVID-19 safe harbour means they have been given a significant marketing tool by the government, to urgently encourage those considering appointment of an external administrator to act urgently and make an appointment before 25 September 2020 to have the best chance of their ship reaching shore.

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Footnotes

1. Explanatory memorandum Coronavirus Economic Response Package Omnibus Bill 2020 at [12.16].
2. Above, at [12.18].
3. Giddings, M *Timing is everything — statutory demands under Australia's coronavirus temporary relief measures* (2020) 20(8) INSLB 156 at p 157.