TMA
Australia Chapter

19 June 2017

Dear fellow Members of TMA Australia,

Over the past two years the Commonwealth Government has promoted a review of the Australian insolvency laws. In particular, the focus has been on whether it makes sense to provide directors of stressed and distressed corporates with a "safe harbour" to work with suitably qualified turnaround professionals. This will allow directors to create a plan, without fear of incurring liability for insolvent trading. The TMA has been a strong advocate and active participant in Government's framing of the proposed safe harbour. Legislation to give effect to this concept is now before the Parliament, which is anticipated to be passed into law in coming months.

In anticipation of the enactment of this law, your Board has crafted a set of guidelines and explanatory notes for members to assist them in navigating the introduction of these laws. With the legislation yet to pass, there is likely to be amendments to these guidelines and members should watch for updates as further insights are incorporated.

We would like to thank Board members for their work on this initiative, and it is particularly pleasing to see one of our young NextGen members taking a significant role in the drafting process and we would like to thank Kathryn Smith of Ashurst for doing so.

We commend these guidelines to you for your consideration as this exciting development unfolds in coming months.

With kind regards,

Tim Stewart
Chairman

Lachlan Edwards
President

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TMA BEST PRACTICE GUIDELINES – NAVIGATING SAFE HARBOUR

Phase	Starting to suspect insolvency/risk of insolvency	Assessing and entering Safe Harbour	Planning course(s) of action	Taking action	Leaving Safe Harbour
Phase Objective	Conduct initial assessment of financial position	Assess availability of Safe Harbour and resolve to enter	Develop and approve a turnaround plan	Implement turnaround plan and monitor performance regularly	Assess the success or failure of the course of action taken
Available Steps	Directors form an initial view on whether the company is solvent or at risk of insolvency	Engage "appropriately qualified entity/entities"*	Enter into standstill arrangements with key creditors (if required)	Hold regular board meetings where the course(s) of action are reviewed and monitored against milestones	Assess whether the company is solvent and has achieved long-term viability or whether a formal insolvency appointment or solvent wind down is required
	Directors seek legal, strategic and financial advice, as appropriate	Assess threshold issues: is the company able to pay employee entitlements and comply with tax reporting obligations?	Form a turnaround committee of key stakeholders (if appropriate)	Company must manage key stakeholders and maintain appropriate financial records	
	The company avoids incurring fresh debt	Urgently take steps to address any officer/employee misconduct	Implement crisis stabilisation and cash management processes (if appropriate)	Directors must continue to comply with all their general law and statutory duties, including financial monitoring	
	Directors document steps taken through board meetings, file notes and records of advice	Determine whether a standstill period can be agreed with financiers/ key creditors	Formulate the turnaround plan. Advisors provide a written "better outcome" opinion on proposed course(s) of action	Company must comply with continuous disclosure obligations (if applicable) and continue to pay employee entitlements and satisfy tax reporting obligations	
	Directors consider insurance position (if appropriate)	Advisors form a view on availability of Safe Harbour. Board passes a resolution to implement Safe Harbour (if appropriate)	Obtain stakeholder approval of plan (if required). Pass board resolution approving the plan (if appropriate)	Change course(s) of action if necessary	
Evidence Outputs	1. Documented assessment of financial status of company by directors and advisors	1. Documented engagement of appropriately qualified entity 2. Confirmation that threshold issues are satisfied 3. Formal recommendation on Safe Harbour 4. Board resolution to implement Safe Harbour (if appropriate)	1. Formal restructuring plan documented, including better outcome opinion 2. Documented stakeholder views (if appropriate) 3. Board resolution to implement the plan 4. Documented timetable and responsibilities for execution	1. Regular board meeting minutes which document continued consideration of plan 2. Progress reports against milestones 3. Updated forecast financial models 4. Appropriate reporting to stakeholders and market	

Timing

The turnaround plan must be implemented within a reasonable period, having regard to the size and nature of the business.

The above visual aid is not necessarily meant to represent a linear structure. The process outlined in this guide should unfold as efficiently as possible. In this regard, it may be appropriate for some actions to occur contemporaneously.

***Who is an "appropriately qualified entity"?**

The legislation does not specify who will constitute an "appropriately qualified entity". In the TMA's view, the following qualifications should be held:

- expertise in the operational, management, financial and legal aspects of a restructuring;
- tertiary qualifications (or their equivalent) in turnaround;
- demonstrable turnaround/ restructuring experience; and
- compliance with the code of ethics and professional development requirements of the person's relevant accrediting organisation.

All Certified Turnaround Professional accredited members of the TMA meet these standards.

The company may be best served by a combination of professionals, including registered liquidators, lawyers, accountants and/or investment bankers.

Assessment of solvency

The directors must undertake an initial assessment of whether the company is insolvent or at risk of becoming insolvent. Time is of the essence in doing so.

The test for determining whether a company is solvent is whether the company is able to meet its debts as and when they fall due. This is a cash flow test rather than a balance sheet test.

Independent legal and financial advice are recommended at this stage.

The board should defer incurring any fresh debts or expenses and avoid renewing any leases at least until a decision on the appropriateness of Safe Harbour is reached in the following phase.

The steps taken for the solvency assessment should be carefully documented through board minutes, file notes and records of advice. This is important because Safe Harbour may be taken to apply as early as when the directors start deliberating on the course(s) of action.

Consideration should be given to disclosure and notification obligations under any relevant directors' and officers' insurance policies, if applicable.

Further resources

- TMA Elements of a Turnaround
- INSOL Statement of Principles for a Global Approach to Multi Creditor Workouts
- Slatter, Lovett and Barlow, *Leading Corporate Turnaround* (2006) Jossey-Bass

Resolving to enter Safe Harbour

If the board has determined that the company is insolvent (or at risk of insolvency), it must now decide on whether Safe Harbour is available or whether to invoke a formal insolvency process, such as voluntary administration.

If independent legal and financial advice has not yet been sought by the company, such advisors should now be formally engaged. The advice of an "appropriately qualified entity"* is one of the matters on which the Court will look favourably when assessing whether Safe Harbour was properly available to the directors.

The board and advisors must consider whether the company can satisfy the conditions for Safe Harbour. In particular, Safe Harbour is not available if the company is unable to pay employee entitlements and/or comply with its tax reporting obligations.

The disposition of key stakeholders (and in particular financiers) towards standstill arrangements may need to be confirmed, to assess the possibility of action/security enforcement which may adversely affect any Safe Harbour period.

Any concerns that misconduct by officers or employees of the company is occurring that could adversely affect the company's ability to pay all its debts should be urgently addressed concurrently with this assessment process.

The advisor(s) should, based on all available circumstances prevailing at the time, provide a view to the board as to whether Safe Harbour is available to the company.

The board should carefully consider whether Safe Harbour is available to the company and make an appropriate resolution having regard to the advice.

Turnaround Planning

Once the board has resolved that Safe Harbour is available, standstill arrangements with key lenders and other creditors may need to be pursued to give the company time to develop and implement a turnaround plan.

If appropriate, crisis stabilisation, including aggressive cash management, should also begin immediately.

Communication with financiers is usually critical in turnaround situations. Serious consideration should be given to communicating with key financiers and continued engagement with them during the period of Safe Harbour.

The turnaround plan be formulated and it should address operational, strategic and financial issues. The turnaround plan may comprise of one or more courses of action, depending on what is reasonably likely to lead to a better outcome for the company. The plan should contain a clear set of steps required to implement the proposed course(s) of action and a timetable of milestones that are capable of objective assessment.

Advisors should be prepared to provide a "better outcome" opinion on the turnaround plan. This means taking a view on whether the plan is objectively likely to produce a better outcome for the company than the immediate appointment of a liquidator or administrator. The assessment of the better outcome will require careful legal and financial analysis of the individual circumstances and options.

The turnaround plan should be formally adopted by board resolution, if the board is satisfied that the plan is viable and is reasonably likely to produce the requisite "better outcome" for the company.

Implementation and Monitoring

The turnaround should be implemented within a reasonable period and otherwise in accordance with its timetable.

A formal agreement may need to be entered into with financiers to replace any standstill arrangements.

Generally, management should strive to instil sense of urgency and performance-orientation in staff to effect the turnaround plan. Changes to management should be made as necessary, to support the turnaround. Financial controls should remain tight.

The board must carefully monitor the implementation and performance of the turnaround plan against key milestones. Employee entitlements and tax obligations must continue to be met. Relevant financial information should be regularly considered.

All board meetings should be appropriately minuted and board packs containing the relevant advice, progress reports and financial information should be circulated and filed with the minutes. Directors should continue to seek advice from their appointed advisors. In addition, a "restructuring officer" who can act as a special adviser to the chairman of the board may be appointed for efficient project management of the turnaround plan.

Key stakeholders should be kept informed of the progress of the turnaround plan.

The board must continue to comply with general law directors duties. Compliance with any applicable continuous disclosure obligations under the *Corporations Act* and/or ASX Listing Rules must also be maintained.

The turnaround plan should be viewed as a living document. It should be varied, as required, to achieve the requisite "better outcome".

If, at any time, having regard to the prevailing circumstances and the its advice, the board considers that the turnaround plan is no longer viable or the conditions for Safe Harbour can no longer be met, the company must reconsider its options, including proceeding to voluntary administration/liquidation.

Leaving Safe Harbour

Once the plan has been fully implemented (including any necessary variations), the board should re-assess the financial position of the company with the assistance of advisors.

If the workout during the Safe Harbour period has been successful and long-term viability of the company has been achieved, the company should work to institutionalise relevant improvements.

If the company is solvent, but is still underperforming it may be appropriate to consult further with turnaround professionals and consider options such as a solvent wind down or a business/asset sale.

If the company has remained insolvent or become insolvent the board will likely need to make the appropriate resolution to invoke a formal insolvency process.

If the appointment of a voluntary administrator or liquidator follows the Safe Harbour, it is critical that directors comply with their duties to assist the relevant insolvency practitioner(s) and provide books and records as required by the *Corporations Act*.

Failure to do so may result in Safe Harbour protection from insolvent trading liability becoming unavailable to directors.