

Directors' Duties and Safe Harbour in light of COVID-19

There can be no doubt that the outbreak of the coronavirus (COVID-19) has had an immediate and significant effect on the financial stability of many companies. When the economic landscape is changing so rapidly, it can be difficult to assess financial performance. However, this assessment is integral to enabling company directors to take proactive steps to save their business and reduce their own personal liability.

We provide an overview of a directors' duties and measures a director can put into place to ensure they minimise their own personal liability.

Directors' Duties

- (1) Directors have both common law and statutory duties under the *Corporations Act 2001* (Cth).
- (2) Directors have statutory duties to:
 - (a) exercise powers and discharge duties with care and diligence;
 - (b) exercise power and discharge duties in good faith in the best interests of the respective company;
 - (c) not improperly use their position to gain an advantage for themselves or someone else or to cause detriment to the respective company;
 - (d) not use information obtained as a consequence of their role to gain an advantage for themselves or someone else or to cause detriment to the respective company;
 - (e) take reasonable steps to ensure that the company complies with the obligations related to the keeping of financial records and financial reporting; and
 - (f) disclose any material personal interest in respect of the companies when a conflict arises.
- (3) In addition to these statutory duties, directors have common law duties to act in good faith, avoid conflicts of interests and to act for a proper corporate purpose (i.e. not to exercise their power to obtain some personal advantage).
- (4) The Corporations Act also imposes a duty on directors to prevent a company from incurring a debt when the director has reasonable grounds to suspect the company is, or may become, insolvent. Under Australian law, a company is considered to be insolvent when it is unable to pay its debts as and when they fall due and payable.
- (5) Although there are some defences available to a director, a breach of these directors' duties can expose a director to a range of civil or criminal penalties.

Insolvent trading

As part of the effort to minimise the effects of Covid-19, the Australian Government has announced some significant changes to insolvency law, including temporary relief for directors from any personal liability for trading while insolvent for debts incurred in the ordinary course of a company's business.

This new moratorium will apply to debts incurred on or after 25 March 2020 for 6 months.

Notwithstanding these changes, for companies experiencing or forecasting any financial distress, the most prudent course is to seek advice. The moratorium does not waive any obligation to continue to observe a directors' duties pursuant to both statutory and common law provisions.

A key piece of legislation that directors can also rely on in respect of insolvent trading is known as the safe harbour provisions, not just to protect oneself from personal liability, but to ensure the long-term viability of the company's business.

What is safe harbour?

- (1) The safe harbour regime offers protection for directors in trading through periods of financial uncertainty without being exposed to claims for insolvent trading.
- (2) The safe harbour regime allows directors of companies to permit their company to continue to trade, even if they suspect the company may be insolvent now or at some future time, provided that the directors have formulated and put in place a 'course of action' reasonably likely to lead to a better outcome for the company than if the company were wound up or placed into voluntary administration immediately.
- (3) In order to obtain the benefit of the safe harbour regime, the company needs to continue to pay employee entitlements when they fall due, and comply with tax obligations by lodging returns, notices, statements, applications and other tax documents.
- (4) A properly advised director that enacts an appropriate safe harbour strategy will be entitled to rely upon the safe harbour strategy as an 'exception' to any claim of insolvent trading.
- (5) Directors should seek appropriate (and early) advice if they are concerned about the financial stability of a company, including to ensure the viability of the business and its stakeholders, to minimise reputational risks and personal liability.