Detailed summary

Duty to prevent insolvent trading: Guide for directors (RG 217)

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ASIC releases updated guidance on insolvent trading and the safe harbour defence

On 6 December 2024, the Australian Securities and Investments Commission (**ASIC**) issued an updated regulatory guide for directors and their professional advisers on the duty to prevent insolvent trading, including new guidance on the safe harbour defence. The updated Regulatory Guide 217 *Duty to prevent insolvent trading: Guide for directors (RG 217) has been divided into the following four parts:*

PART A	**Overview**
PART B	**Key principles for directors**
PART C	**Safe harbour protection from liability for insolvent trading**
PART D	**ASIC's approach to insolvent trading and safe harbour**

PART A – OVERVIEW

Part A of RG 217 discusses three important concepts for directors: the director's duty to prevent insolvent trading, safe harbour protection and liability of holding companies.

Director's duty to prevent insolvent trading

ASIC's regulatory guidance reiterates that directors must prevent their company from incurring debts if the company is insolvent or would become insolvent by incurring the debt, pursuant to section 588G of the *Corporations Act 2001* (Cth) (**Corporations Act**). This duty applies to all directors, both those who are appointed to the position and any alternate director they appoint and who is acting in that capacity. RG 217 indicates that if a director is found by a court to have contravened the civil penalty provision in s588G(2), the court may make one or more of the following orders:

- Compensation order
- Pecuniary penalty order
- Disqualification from managing a corporation

This part also contains information for directors on when a company is insolvent and what defences are available.

Safe harbour protection

Directors may be able to protect themselves from civil liability for insolvent trading by establishing a 'safe harbour'. A director may have safe harbour protection and be excluded from civil liability for insolvent trading if they developed a course of action that is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator.

Liability of a holding company

A holding company can be liable for the insolvent trading of its subsidiary if it was aware, or should have been aware, of the subsidiary's insolvency. Holding companies can also rely on safe harbour protection if they take reasonable steps to ensure their directors comply with the safe harbour provisions.

PART B – KEY PRINCIPLES FOR DIRECTORS

Part B of RG 217 sets out the following four key principles that directors should be aware of in the context of their duty to prevent insolvent trading:

- Actively monitor company solvency
- Investigate financial difficulties
- Obtain advice from professional advisers where necessary
- Act in a timely manner

If a director does not actively follow the above principles, they may be at serious risk of breaching their duty to prevent insolvent trading.

Actively monitor company solvency

Directors, both executive and non-executive, must actively monitor and stay informed about the company's financial position. This includes ensuring proper financial records are maintained and making reasonable inquiries to understand the company's financial status and cash flow needs. ASIC indicates that directors will not be excused from this duty unless there are exceptional reasons, such as serious illness or being overseas with an appointed alternate director. Relying solely on others without taking an active interest is insufficient.

RG 217.43 sets out specific activities that directors may need to undertake to ensure that they are sufficiently informed about the company's position, including:

- Overseeing the preparation of profit and cash-flow budgets and monitoring actual results against expectations
- Regularly reviewing the company's ability to collect debts and realise other current assets
- Monitoring when creditors are due to be paid and the company's ability to comply with terms of trade
- Reviewing the current level of bank lending facilities and the ability to access additional funding
- Ensuring compliance with tax obligations and timely payment of employee entitlements

Directors may rely on information from others, such as accountants or financial officers, but must ensure these individuals are qualified, competent, and reliable. Directors should also ask sufficient questions to understand the financial implications of the advice received.

Investigate financial difficulties

The second key principle highlights that directors should take prompt and positive steps to confirm the company's financial position as soon as there are reasonable grounds to suspect financial difficulties or insolvency risk. Directors should realistically assess the available options to address the company's financial difficulties to ensure it can meet its obligations. RG 217.51 also indicates that directors should ensure systems are in place to carefully consider the company's solvency before incurring new debts and obtain advice from a professional adviser if necessary.

Obtain advice from professional advisers where necessary

The third key principle highlights that directors should seek appropriate advice as soon as there are reasonable grounds to suspect the company is in financial difficulty. Advice should be obtained from appropriately qualified, insured, competent, and reliable professional advisers, such as registered liquidators, lawyers, or accountants.

ASIC's guide states that directors must provide full, complete, accurate, and up-to-date information to the adviser to enable them to give competent advice. Directors should carefully consider the advice received and take timely and appropriate action based on it.

Act in a timely manner

The fourth key principle reinforces that directors must act promptly when there are reasonable grounds to suspect the company is insolvent or at risk of insolvency. Directors should carefully consider any advice received, including its qualifications and assumptions, and take appropriate action based on it. RG 217 states that directors should continue to monitor the company's financial position closely and be prepared to take further action if the company's ability to meet its debts deteriorates.

If the company is already insolvent, directors must take immediate steps, such as obtaining further advice or preventing the company from incurring further debts. ASIC indicates that directors should also document their actions and decisions to demonstrate they have taken reasonable steps to address the company's financial difficulties.

PART C – SAFE HARBOUR PROTECTION FROM LIABILITY FOR INSOLVENT TRADING

Part C of ASIC's RG 217 provides guidance on a director's defences against insolvent trading and more specifically, a director's ability to establish safe harbour protection from civil liability for insolvent trading. Directors can protect themselves from civil liability for insolvent trading by establishing a 'safe harbour' if they start developing a course of action reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator.

ASIC sets out that directors have the ability to rely on safe harbour protection if they:

- ensure that none of the factors that prevent safe harbour protection from operating exist
- start developing one or more courses of action that are reasonably likely to lead to better outcome for the company than the immediate appointment of an administrator or liquidator
- ensure that only debts connected to the course of action are incurred, or ensure that only debts are incurred in the ordinary course of the company's business
- when the course of action is no longer reasonably likely to lead to a better outcome for the company, consider the immediate appointment of an external administrator to the company or, if an external administrator is not to be appointed, immediately cease incurring debts
- ensure the steps the director has taken to develop and implement the course or courses of action are adequately documented so that supporting evidence can be available if necessary

A director who wishes to rely on the safe harbour protection in relation to a debt bears the onus of proof. This means directors will need to prove that they acted proactively in undertaking a restructure of the company as soon as they suspected insolvency.

When safe harbour protection is not available

Safe harbour protection is not available if the company is failing to:

- pay employee entitlements (including superannuation), that are due and payable; or
- comply with its lodgement obligations under taxation laws.

Failure to meet these obligations, if it amounts to less than substantial compliance or is a repeated failure within the last 12 months, will disqualify the directors from safe harbour protection.

RG 217 also indicates that if a controller, administrator, or liquidator is appointed and the director fails to comply with their obligations to provide necessary reports and information, safe harbour protection will not apply.

Course of action

A director may develop one or more courses of action that are reasonably likely to lead to a better outcome for the company. ASIC highlights that directors should have a proper basis for deciding on a course of action, which includes obtaining advice from an appropriately qualified entity and documenting the rationale for the chosen course.

Possible courses of action that directors may take include:

- Conducting a business review
- Raising capital or executing a debt-for-equity swap
- Restructuring or compromising debt facilities
- Addressing operational issues affecting the company's financial position
- Implementing cost-saving measures
- Negotiating with key creditors or stakeholders
- Preparing for the appointment of a registered liquidator or a small business restructuring practitioner
- Selling non-core or core business assets if appropriate

ASIC also reiterates that directors must continue to comply with their general duties set out in the Corporations Act while they develop a course or courses of action.

Better outcome

Pursuant to section 588GA(7) of the Corporations Act, a better outcome for the company means an outcome that is better for the company than the immediate appointment of an administrator or liquidator of the company. RG 217 indicates that a better outcome for the company will vary depending on the company's circumstances at the time the course or courses of action are developed, and the decision is made. This may include matters such as the size and financial position of the company, the industry in which the company operates as well as the complexity of issues affecting the company's viability. Directors should also monitor changing circumstances during the development and implementation of a course of action and make adjustments to ensure the course of action is still likely to lead to a better outcome for the company.

Debts included in safe harbour protection

Safe harbour protection covers debts incurred directly or indirectly in connection with developing and implementing a course of action that is reasonably likely to lead to a better outcome for the company than immediate liquidation. This includes debts incurred in the ordinary course of the company's business, as well as those specifically related to the course of action.

Obtaining appropriate advice

ASIC indicates that directors should obtain advice from an appropriately qualified entity that is suitably qualified, adequately insured, competent, and reliable. This advice should cover the company's financial position, how to address financial difficulties, and whether the course of action is likely to lead to a better outcome for the company. Additionally, directors must provide complete, current, and relevant information to the advising entity. This includes ensuring that cash flow projections and other financial details are objectively reasonable.

However, RG 217 reiterates that while advisers provide guidance, directors remain responsible for deciding which course of action to pursue, considering the advice obtained.

End of safe harbour protection

The safe harbour protection will end when the earliest of any of the following occurs:

- the director fails to take up the course of action within a reasonable period;
- the director ceases to take any course of action;
- the course or courses of action cease to be reasonably likely to lead to a better outcome for the company; or
- an administrator or liquidator is appointed to the company.

PART D – ASIC'S APPROACH TO INSOLVENT TRADING AND SAFE HARBOUR

Part D provides a list of factors that ASIC will consider when determining whether a director has breached their duty to prevent insolvent trading or whether they may rely on safe harbour protection. ASIC notes that when assessing a particular case, they will take into account the key principles set out in Part B and the guidance in Part C, and consider the extent to which a director has followed them.

Part D of RG 217 contains a summary table of factors that ASIC will take into account in assessing whether a director has breached their duty to prevent insolvent trading. Key factors include:

- The information the director had at their disposal to form the view that the company was solvent, and its accuracy;
- Whether the director monitored the financial affairs of the company and made sufficient inquiries into its financial affairs on a regular basis;
- Whether there were indicators of potential insolvency that a reasonable person would have taken into account in determining whether the company was insolvent;
- Whether the director sought advice immediately on identifying concerns about the company's viability;
- If the director knew, or had reasonable grounds to suspect, that the company was not able to meet its debts, whether the director took active, timely and genuine steps to prevent the debt being incurred;
- Whether debts incurred by the company were incurred directly or indirectly in connection with the alternative course of action; and
- Whether any of the factors preventing safe harbour protection are present.

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