

# MANAGING RISK

## THROUGH THE CONSTRUCTION SHUTDOWN

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**RAPSEY GRIFFITHS**  
TURNAROUND + ADVISORY

## What We'll Cover...

- Warning Signs of Financial Distress
- Avoiding the Pitfalls
- Record Keeping
- Ipso Facto Provisions
- Insolvency
- Insolvent Trading and Defences
- Safe harbour
- Small Business Restructuring Plan
- What if a Turnaround Attempt Fails?

## Warning Signs

- Cash flow difficulties
- Continuing trading losses
- Creditors not being paid on agreed trading terms
- Not paying taxes when due (PAYG instalments, GST, Superannuation Contributions)
- Legal action is being threatened or has commenced in relation to outstanding debts.
- No further capacity to borrow and/or loan defaults.
- Bad record keeping or inability to produce accurate financial information
- Bad management or lack of operating controls
- Operating without a business plan
- Too much growth too quickly
- Reliance on a few key customers
- Project delays
- Lack of profitability (including due to under-quoting).
- External economic factors such as the COVID-19 pandemic

## Avoiding the Pitfalls

- Forecasting and analysis – financial literacy
- People and business culture
- Record keeping – compliance with section 286 of the Act and assists in identifying the cause of financial difficulties

## In a construction context:

- Building business relationships and continuity of management
- Have the right contract:
  - Correctly identify the parties
  - Deal with reputable parties (ASIC and PPSR Searches)
  - Price accurately
  - What are the obligations of each party?
  - Document variations
  - Document communications
  - Clearly identify what is required for completion of the works
  - Ensure that contractual risks can be controlled (or insured)
  - Ownership of materials
  - Clear constructions program with a means of extending time for delivery where necessary
  - Security – Retention and Bank Guarantees
  - Right to suspend and terminate (including in the event of insolvency or suspected insolvency)
  - Step in rights
- Contracts typically include a right to terminate where an insolvency event occurs or step in rights allowing work to be taken out of the contractor's hands.
- As of 1 July 2018 the Corporations Act has prevented a party from exercising a right under certain contracts (including a right to terminate) that arises due to a formal insolvency restructuring (including voluntary administration, receivership or a scheme of arrangement).

## Insolvency

- Defined in section 95A of the Act - Unable to pay debts as and when they become due and payable.
- Cash flow test – Can the company can pay its liabilities as and when they fall due.
- Balance sheet test – Would the company would have more assets than liabilities if it were immediately wound up?

# Insolvent Trading

- Section 588G of the Act - Duty upon directors to prevent insolvent trading.
- Must be able to pay debts as and when they fall due – cash flow test.
- A director must ensure that a company is solvent prior to incurring additional debt.
- A breach may result in a director being held personally liable to pay compensation for the unpaid debts if the company later goes into liquidation.
- “Director” includes shadow, de facto and alternate directors
- The offence arises if a person:
  - was a director at the time the company incurred a debt; and
  - the company was insolvent at that time, or became insolvent by incurring the debt; and
  - at that time there were reasonable grounds for suspecting the company was insolvent or would become insolvent by occurring the debt.
- Penalties include:
  - Civil and criminal sanctions – Substantial fines and/or imprisonment for up to five years (or both)
  - Disqualification as a company director
- Under s 588M of the Act, a liquidator may bring proceedings against the director to recover debts incurred while insolvent.
- An individual creditor may also bring a claim for the amount of its claim.

## What Should Directors Do?

- Monitor profit and cash flow budgets and creditor payments and arrangements and apply the 'cash flow' test
- Stay informed of the company's financial position and investigate and take action when the company is in distress
- Obtain professional advice
- Act promptly

## Potential Defences

Section 588H contains four available defences for a director who is accused of insolvent trading:

- That he or she had reasonable grounds to expect, and did expect, that the company was solvent and would remain solvent
- That he or she reasonably relied on information provided by a competent and reliable person and expected that the company was solvent and would remain solvent
- That, because of illness or for some other good reason, he or she did not take part in the management at the relevant time
- That he or she took all reasonable steps to prevent the company from incurring the debt or making the disposition of its property  
Directors bear the onus of proving the defences under the Act.

## Safe Harbour

- Under Section 588GA of the Act a company can take advantage of a 'safe harbour' by taking proactive steps to improve its financial situation.
- 'Safe harbour' provides a defence from insolvent trading liability for directors
- It is only available where a genuine turnaround attempt is being made and a 'better outcome test' is met (ie: the turnaround is reasonably likely to lead to a better outcome for the company "than the immediate appointment of an administrator, or liquidator").
- Exercise caution when incurring new liabilities
- To stay protected, a director must be able to demonstrate that he or she:
  - Is informed about the financial position of the company
  - Is taking appropriate steps to prevent any misconduct
  - Is taking appropriate steps to ensure the company is keeping proper financial records
  - Is seeking advice from an appropriately qualified expert
  - Is developing or implementing a plan for restructuring the company
  - Is ensuring that the company is up to date in paying employee entitlements, superannuation and tax lodgements.
- Safe Harbour is not available if the company is unable to pay employee entitlements and/or comply with its tax obligations.

## Formulate a Safe Harbour Plan and Put it in Writing

- All discussions and steps taken should be documented (including through board minutes, file notes and records of advice received).
- The make-up of a turnaround plan will differ depending on the company's situation, however the following are generally relevant:
  - Focus on and monitor cash flow
  - Current labour requirements
  - Management team and structure
  - Culling unprofitable services
  - Liquidating assets
  - Ability to obtain finance/re-finance
  - Improving debt collection, including enforcing or implementing payment terms
  - Eliminating unnecessary capital expenditure
  - Prioritising capital expenditure that maximises return on investment
  - Communicating with employees, creditors, suppliers and financiers
  - Seek professional advice (including when documenting the plan)
  - Clear steps required to implement the plan and a timetable for doing so that can be measured objectively.

## **Formulate a Safe Harbour Plan and Put it in Writing**

- The assessment of whether the plan satisfies the “better outcome” test will generally require careful legal and financial analysis of the individual circumstances and options.
- Key stakeholders should be kept informed of the progress of the turnaround plan and all board meetings at which adherence to the plan is discussed should be appropriately minuted.
- If the turnaround plan is not complied with or fails, or the conditions for Safe Harbour can no longer be met, the company must reconsider its options, including proceeding to voluntary administration/liquidation.

# Small Business Restructuring Plan (SBRP)

- As of 1 January 2021, small businesses experiencing financial difficulties can enter into a SBRP.
- Introduced in the context of COVID, and intended to offer a simpler and cheaper way of avoiding financial crisis, while retaining control of a small business.
- To be eligible, the business must:
  - be operated by a company
  - owe less than \$1 million in liabilities
  - have paid all outstanding employee entitlements including superannuation
  - have all tax lodgements up to date,
  - no person who is a director of the company, or who has been a director of the company within the 12 months before the implementation of the SBRP, can have previously been the director of a company who has implemented a small business restructuring plan or simplified liquidation process in the past 7 years
- A qualified small business restructuring practitioner must be appointed.
- A small business restructuring plan must be prepared in the approved form within 20 days from the appointment of the practitioner

# Small Business Restructuring Plan (SBRP)

- The plan must:
  - Identify the property that is being dealt with
  - Identify how it will be dealt with
  - Provide for the remuneration for the practitioner
  - State the date on which it was executed
- Once the plan is finalised, ASIC must be notified within five days.
- The plan and relevant papers must be served upon affected creditors.
- Creditors have 15 days to vote on it
- If the majority in value of creditors accept it the plan will be approved and become binding on all unsecured creditors.
- If it is rejected the company may be placed into voluntary administration or liquidation

## What if a Turnaround Attempt Fails?

- If the company is insolvent and a turnaround plan is not an option, formal insolvency arrangements need to be considered.
- Which path is best will depend upon the circumstances.
- Issues specific to the construction industry include the impact on contracts, bank guarantees, personal guarantees, claims for set-off, home warranty insurance and WHS issues.

## Voluntary Administration

- Independent administrator will take control of business and assess its viability moving forward
- There is a moratorium on creditors enforcing their claims during this period.
- Deed of Company Arrangement (DOCA)
  - A binding arrangement between a company and its creditors governing how its affairs will be dealt with.
  - Intended to maximise the chance of a company continuing to trade while providing a better return for creditors than liquidation.
  - May involve a third party cash injection or business contributing to a fund to partially repay creditor claims
  - Once the DOCA terms have been complied with the company is released from administration and creditors can no longer recover any unpaid debts from prior to the administration.
- Liquidation
  - Control of the business is handed over to a liquidator to sell of assets and wind up company's affairs

## **Seek Help**

If you have concerns for the solvency of your company ask for help sooner rather than later. The sooner you seek help, the better your chances of survival.

*Questions?*



***Coming  
Tomorrow...***

- 10am Friday 23 July:

## **General Q&A**

**What we've seen and what we expect is still to come**

*Come along with your questions & coffees...*

*Michael Morrissey will be hosting a general Q&A on the major problems and solutions that have emerged from the first week of the construction shutdown, along with what we can expect moving forward.*

*He will be joined by some familiar faces you've seen this week to field the tricky ones on their respective areas:*

*Hamish Geddes - Payment Claims & Contracts*

*Mary Ann Wen - Employment Matters*

*Aaron Bolton - Insurance*

*Georgia Marjoribanks - Corporate Obligations*

# WE'RE HERE TO SUPPORT

As always, specific legal advice should be sought in any circumstance.

Please reach out to us, or your preferred legal service provider, to discuss any and all concerns around the construction industry shutdown.

You can reach us directly here:

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