The impact of the bushfire season and now COVID-19 may offer silver linings for distressed charities. The ACNC has indicated that modifying or even temporarily halting your charity's activities is a reasonable course of action to take. At this stage, your charity's priority should be the safety of staff and volunteers. This may mean that some or all of your charity's activities may need to be modified or even temporarily halted.

But…..all is not doom and gloom! This is an opportunity to restructure and re-invent. The Federal and State Governments have introduced temporary measures to facilitate this. This article sheds some light on the options available to your charity to effectively get on top of this uncertain environment, including:

- The availability of the Safe Harbour protection as a pivot and restructuring tool for your charity
- The use of Hibernation deeds to effectively manage risks

But first, is your charity experiencing solvency issues?

Insolvency is defined as the point when the charity cannot pay its debts as and when they fall due.

You should be aware of the warning signs of insolvency and your obligations under the Corporations Act and the ACNC Governance Standards.

If your charity is on the brink of insolvency, you must take immediate action to:

- Give your charity the best chance to continue to exist, or at least, minimise the consequences.
- Manage your personal liability risk from continuing to trade insolvent.

Temporary regulatory and financial relief for financially distressed charities

On 23 March 2020, the Federal Government passed laws to assist businesses (including charities) with temporary relief for directors from personal liability for trading while insolvent.

- With a six month relief from insolvent trading laws, you can confidently continue to operate your charity through the current crisis and do the much needed charitable work, with the aim of returning to viability once it has passed.
The ACNC has also announced various relief measures, including new guidelines on Annual General Meetings (AGMs) and Annual Information Statements to allow charities to operate effectively during this period.

- ACNC announced that will not investigate certain breaches of the Governance / External Conduct Standards occurring between 25 March and 25 September 2020. The ACNC believes this interim measure will enhance public trust and confidence in the sector.

- You should be aware however that if the ACNC identifies significant and wider non-compliance that harms the public interest, even if it is owing to COVID-19, it may still investigate and take regulatory action.

On 24 April 2020, the NSW Government enacted the *Retail and Other Commercial Leases (COVID-19) Regulation 2020* (Regulation), implementing the *Federal National Cabinet Mandatory Code of Conduct - SME Commercial Leasing Principles during COVID-19* (Code), in NSW.

- The Code is premised on principles of good faith, working together, and proportionate loss sharing; recognising that landlords and tenants share a common interest in maintaining leasing arrangements during the COVID-19 pandemic and through to the recovery. This is another opportunity for restructure.

- The Regulation protects impacted tenants in NSW (including charities) with turnover of up to $50 million, by prohibiting landlords from enforcing the commercial leases (i.e. drawing on the tenant’s security or terminating the lease) for certain breaches during the COVID-19 pandemic period (i.e. non-payment of rent or outgoings or not opening for business). If requested by the tenant, the landlord must renegotiate the rent in good faith on the basis of the Leasing Principles of the Code. The Regulation and the Code are summarised and explained in this Dentons fact sheet.

- Additionally, the Federal Government has also announced rent waiver for all NFP tenants within its owned and leased properties across Australia.

Despite the regulatory and financial relief offered, you need to determine if your charity is suffering from temporary liquidity challenges (owing to COVID-19) or a structure shortage of working capital that cannot be overcome, and consider your longer-term options. This will dictate your options to re-invent and restructure, outside of a formal insolvency process such as voluntary administration.

**Option 1: Safe Harbour protection as a re-pivot and restructuring tool**

The *Safe Harbour* protections are intended to encourage and support you to make early, genuine and potentially ongoing attempts to restructure your charity in an effort to avoid any associated detrimental impacts on all stakeholders including employees, members, volunteers and creditors.

The *Safe Harbour* protections are designed to give you (as a director) breathing space and the opportunity to restructure your charity’s business outside of a formal insolvency appointment. It provides you with protection /
defence from insolvent trading offences under the *Corporations Act* and the Governance Standards, in the unlikely event the restructuring is unsuccessful, and your charity is wound up.

No one is guaranteed to come out unscathed from this crisis, and remain solvent after the government’s temporary relief runs out. That is why you can rely on safe harbour as it offers protection beyond the 6-month period covered by the temporary relief measures to restructure your charity’s business.

More importantly, you remain in control of this process, and your restructuring advisor works with you to develop a turnaround plan. However, to remain eligible, you must ensure compliance of at least the following:

1. All your charity’s employee entitlements are paid by the time they fall due
2. All tax reporting obligations such as giving of notices, statements per the *Income Tax Assessment Act*

The 5 golden rules will help you with safe passage through the harbour. The critical requirement is that you should promptly seek advice from an appropriately qualified advisor. It is not clear who an appropriately qualified adviser is. This depends on your charity’s size and nature, and could be a lawyer or an insolvency practitioner.

A turnaround plan does not need to be long and complex. It should be clear and contain appropriate steps to getting your charity back to financial health, as long as you and your fellow Board members follow the plan.

Your charity’s COVID-19 turnaround plan could look something like this:

<table>
<thead>
<tr>
<th>Managing stakeholders</th>
<th>Reorganise working capital</th>
<th>Funding levers</th>
<th>Assessing future viability and positioning</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Proactive and regular communication with members and volunteers</td>
<td>• Considering use of reserves</td>
<td>• Assessing their eligibility for the Federal Government’s stimulus package - or any state or territory packages</td>
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<tr>
<td>• Liaising with ACNC, ATO and other regulators, funders</td>
<td>• Assessing future cash flows and doing a forecast - or adjusting their forecast - in light of current events</td>
<td>• Rightsizing workforce</td>
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<td>• Media relations</td>
<td>• Knowing fixed costs and when they will need to be paid. Also, not committing to any more expenditure if possible</td>
<td>• Create appropriate risk management protocols and internal controls</td>
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<tr>
<td>• Engagement and updates to employees and suppliers</td>
<td>• Reviewing existing liabilities (for example, exploring options with banks or financial institutions, including deferring loan repayments if applicable)</td>
<td>• Identify other sources of funding: sale and lease back arrangements, sale of non-core assets</td>
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<tr>
<td>• Creditor management and ongoing reporting</td>
<td>• Renegotiate with key suppliers to change</td>
<td>• Considering any other financial assistance available (for example, business relief packages from banks or financial institutions)</td>
<td>• Assessing future viability of charity</td>
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<td>• Redesign operating model</td>
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<td>• Identify alternative solutions including possibility of merger with other charities, voluntary administration, voluntary winding up and other options</td>
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Option 2: Hibernation Deeds for risk management

Hibernation is now the talk of the town. What it looks like is however not quite clear. Many view a “Hibernation Deed” (HD) as a creature of the Safe Harbour regime. However, a distinction needs to be made that the Safe Harbour regime is a statutory enshrined protection in the Corporations Act requiring strict eligibility requirements. If you do not meet the strict requirements of a Safe Harbour regime but do not wish to enter into a formal insolvency process such as voluntary administration, an HD may be a viable solution.

However you need to ask yourself – will a temporary legal deferment of payment to creditors allow your charity to not trade insolvent and trade profitably? If the answer is no, then it may be worth considering formal insolvency options and a HD may not be suitable to your charity.

A HD can simply be viewed as a “deal” between your charity and its creditors. At its core, an HD should enable your charity to “hibernate” for a period with a view to re-emerging when normalcy returns. Accordingly, as part of an HD, the key features include:

- Suspension of normal business trading during a Hibernation period of say, six months
- Compromise deal with employees
- Arrangement with creditors
- Protection for you and your board members against insolvent trading offences
- Reporting to creditors, to explain the deal and alternative courses of action available

Note that as at the date of this paper, there is no clarity from the ACNC on whether hibernation arrangements of the sort described above is compliant with the charity’s legal and compliance obligations. The law however certainly appears flexible enough to allow an HD to work.

Conclusion

In conclusion, directors of charities have various options available to them to navigate the economic and regulatory challenges posed by COVID-19.

Seeking professional advice promptly may be the difference between the continued sustainability of your charity. The Dentons NFP team will be delighted to assist you in restructuring and re-inventing your charity.
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