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# Covid Changes to Insolvency Rules

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COVID-19 (novel coronavirus) has had a significant impact on the global economy, and the effects of this will be felt for weeks to come. New Zealand's economy has not escaped this impact; fortunately we live in a country where legislative action is being taken to soften the blow of COVID-19. The Government is taking recommendations from industry groups and putting in place frameworks to support New Zealanders during this time.

Many businesses will be under immense pressure and will be putting continuity plans into action in order to weather the current storm. Unfortunately however, this will not be possible for all businesses and it is something all directors need to keep in the back of their minds. Why? Because directors, as the 'mouthpiece' of their company, act on its behalf and as such, have certain duties under the Companies Act 1993 ("the Act") they <u>must</u> comply with. If these are breached, the protection of limited liability falls away and directors can become personally liable.

In our current situation, several duties become particularly relevant. These include (but aren't necessarily limited to):

- the duty of directors to act in good faith and in the best interests of the company under section 131 of the Act;
- the duty to ensure the company does not trade recklessly (i.e. trade in  manner likely to create a substantial risk of serious loss to the company's creditors)  under section 135 of the Act;
- the duty not to incur an obligation unless  the director believes on reasonable grounds that  the company will be able to meet that obligation under section 136 of the Act; and
- the director's duty of care under section 137 of the Act.

Continuing to trade when, in reality, it is likely the company cannot perform the obligations it has entered into or it is insolvent may constitute a breach of a number of such duties.

To support New Zealand businesses over this difficult time, the Government intends to introduce several temporary changes to the New Zealand insolvency regime. These changes will include:

- giving directors of companies facing significant liquidity problems because of COVID-19 a 'safe harbour' from insolvency duties under the Act; and

- enabling businesses affected by COVID-19 to place existing debts into hibernation until they are able to start trading normally again.

We explore these changes in more detail below:

## Safe Harbour

Directors' decisions to keep on trading, as well as decisions to take on new obligations, over the next 6 months will not result in a breach of duties under sections 135 and 136 of the Act if:

- in the good faith opinion of the directors, the company is facing or is likely to face significant liquidity problems in the next 6 months as a result of the impact of the COVID-19 pandemic on them or their creditors;
- the company was able to pay its debts as they fell due on 31 December 2019; and
- the directors consider in good faith that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months (for example, because trading conditions are likely to improve or they are likely to able to reach an accommodation with their creditors).

It is intended that the safe harbour provisions be backdated to the date of the announcement.

## Business Debt Hibernation Scheme

The Government will introduce a COVID-19 Business Debt Hibernation regime to the Act.

The proposed regime is intended to:

- encourage directors to talk to their creditors with a view to putting together a simple proposal for putting the business into hibernation;
- allow for the directors to retain control of the company, rather than passing control to an insolvency practitioner; and
- provide certainty to new creditors that they won't have to repay any money they receive, so as to encourage businesses to continue transacting with businesses in Business Debt Hibernation.

Key features of the Business Debt Hibernation regime are that:

- directors will have to meet a threshold before being able to access the regime and putting a proposal to their creditors;

- creditors will have a month from the date of notification of the proposal to vote on it, with the proposal going ahead if 50% (by number and value) agree; and
- there will be a one month moratorium on the enforcement of debts from the date the proposal is notified, and a further 6 month moratorium if the proposal is passed.

Some other key legislative changes to support businesses are:

- allowing the use of electronic signatures where necessary due to COVID-19 restrictions;
- giving the Registrar of Companies the power to temporarily extend deadlines imposed on companies, incorporated societies, charitable trusts and other entities under legislation;
- giving temporary relief for entities that are unable to comply with requirements in their constitutions or rules because of COVID-19; and
- Bring forward an insolvency-related reform under the voidable transactions regime to reduce the period of vulnerability from 2 years to 6 months where the debtor company and the creditor are unrelated parties.

One further point to note – the Insolvency Practitioners Regulation Act 2019 and the Insolvency Practitioners Regulation (Amendments) Act 2019 are scheduled to come into force on 17 June 2020. Although 17 June remains achievable, and is still being targeted, unpredictability associated with COVID-19 means that implementation may have to be deferred. To cater for unexpected COVID-19-related delays, Cabinet has agreed to allow the commencement of the Insolvency Practitioners Regulation Act 2019 and the Insolvency Practitioners Regulation (Amendments) Act 2019 to be deferred for up to 12 months.

These are difficult and uncertain times and it is imperative that directors fully comprehend their obligations, and how these are affected by the most recent changes.

## *Further Advice*

If you'd like further advice please contact Aaron Crampton at
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