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Significant changes to Company Law announced

On Friday, 3 April 2020, the Government announced significant insolvency law changes in response to the likely economic impact of COVID-19 and the current lockdown (<https://www.beehive.govt.nz/release/further-measures-support-businesses>). The Government will amend the Companies Act 1993 to provide additional comfort to directors of companies during the next six months, and will also introduce "Covid-19 Business Debt Hibernation" as an option to help businesses survive the deterioration in the business environment (<https://www.companiesoffice.govt.nz/about-us/what-we-do/insolvency-relief-for-businesses-impacted-by-covid-19/>). Parliament will have to pass legislation to give effect to the proposed changes, although the proposed legislation has not been made public.

Business Debt Hibernation

The business debt hibernation scheme is the most novel element of the proposed changes. Debt hibernation will be an additional insolvency mechanism, and not a variation of procedures currently available under the law. The announced intention is to allow, "*businesses affected by COVID-19 to place existing debts into hibernation until [the businesses] are able to start trading normally again*". Business Debt Hibernation would be available to companies, and a range of other entities - but not to sole traders; it will also not be available to insurance companies, banks and non-bank deposit takers.

The scheme is intended to be simple and flexible, with a view to a scheme being put into effect quickly. Hibernation is expected to be a step which businesses can take for themselves, without needing any external appointee to operate the business. Directors of companies seeking to "hibernate" their debts will have to meet a minimum (unannounced) threshold before a company

is eligible to put a proposal to creditors. It could be expected that minimum requirements would be that a business was solvent and would have been solvent, aside from COVID-19, and that it would be in the best interests of the business, including its ability to pay creditors, for the business to enter debt hibernation.

If a business proposes debt hibernation, there will be a moratorium period of one month on the enforcement of debts from the date a proposal is notified to creditors. If 50% of a business's creditors by number and value agree to the proposal, the scheme will be binding on all creditors (except for employees). If the creditors agree to the proposal, there would be a further six-month moratorium on enforcement of debts. If creditors do not agree, businesses can still use any other available procedure, such as administration.

If a Business Debt Hibernation proposal is accepted by creditors, a business could continue to trade. Furthermore, any transactions at arm's length with unrelated parties which takes place during the hibernation period would not be a "voidable transaction" in the event of a subsequent liquidation of the company. If a company is subsequently liquidated, the liquidator could not seek to reverse transactions occurring in the hibernation period. A business's counter-parties should thereby have confidence that they would not be increasing their risk to any business by trading with that business while it is in debt hibernation. (A proposed substantive change to the law of voidable transactions will also be brought forward.)

One can foresee some degree of uncertainty as to the scope of contractual obligations which could be characterised as "debts", and which would be temporarily unenforceable. It is also not apparent whether debts owed to secured creditors could be subject to hibernation - a business under financial stress might, at the same time, be increasing its exposure to its secured creditors (particularly if it is using the Business Finance Guarantee Scheme, which is to be accessed through banks in the first instance (<https://www.business.govt.nz/covid-19/business-finance-support-and-mortgage-holidays/>)); nor has it been announced how any moratorium would affect rights against guarantors of business debts. Hopefully, these matters will become clearer when more details are announced.

Protection for Company Directors against Claims of Reckless Trading

The second main element of the proposed changes is the creation of what is sometimes called a "safe harbour" for company directors. The Government plans to amend sections 135 and 136 of the Companies Act 1993. Under section 135 a company director is potentially exposed to personal liability for allowing a company to trade in a way which could create a substantial risk of serious loss to creditors. Under section 136, a director is potentially exposed if the director agrees to the company incurring an obligation which the director does not reasonably believe that the company will be able to perform.

It is proposed that the law be amended to provide that a decision by a director to keep trading and incurring new obligations over the next six months would not be a breach of duty if:

1. 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;
2. the company was able to pay its debts as they fell due on 31 December 2019; and
3. 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 be able to reach an accommodation with their creditors).

It is intended that the legislation be given effect from 3 April 2020. There are no other proposed changes to a director's duties.

While it could be debated whether a change to the law was strictly necessary, the proposed amendment gives the strongest possible signal to company directors that they would not be personally exposed for deciding to continue the business of the company in the short term.

Other Changes

Many of the other measures announced are administrative - albeit important - such as extending deadlines for some filings with the Companies Office, or temporarily relieving companies from constitutional requirements which might be impossible to perform currently (such as shareholder meetings).

Conclusion

Many other countries have made changes to their laws which a few weeks ago would not have appeared even remotely likely. Many, including Australia and the United Kingdom, have made changes similar to those proposed in relation to directors' duties. However, there appear to be many unique features of the Business Debt Hibernation scheme: it is as if struggling businesses will be allowed to create a facsimile of themselves to keep functioning, while the original is put into isolation, and an assessment can be made of the likelihood of recovery; like all quarantines, only time will let us assess how effective the proposed measures will be

This article is of a general nature and is not intended to be relied upon as legal advice. Please contact Andrew Skinner at Martelli McKegg if you wish to discuss (09 300 7622).

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