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COVID response - Safe Harbours and Debt Hibernation Scheme now law

By Mathew Martin and Bill Gambrill - 19 May 2020

On 15 May 2020 the COVID-19 Response (Further Management Measures) Legislation Act 2020 became law. This means that two key insolvency measures aimed at addressing the serious insolvency risks arising from the COVID-19 crisis - the "safe harbour" regime and the "debt hibernation scheme" - are now effective in New Zealand.

We wrote about these measures when they were announced, but before the details had been finalised. We have also written a detailed analysis of these new measures, to be found here. In summary, the following key measures are now in place.

Safe Harbours

Company directors of eligible companies are now temporarily exempt from the director's duties contained in sections 135 and 136 of the Companies Act regarding reckless trading and incurring obligations.

A director may be exempt from reckless trading requirements if:

- The company has, or in the next 6 months is likely to have, significant liquidity problems; and
- The liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and
- It is more likely than not that the company will be able to pay its due debts on and after 30 September 2021 (or such later date as prescribed by regulations).

A director may be exempt from their duty relating to obligations if:

- During the safe harbour period only, they agree to the company incurring an obligation; and
- At the time of agreeing to the company incurring the obligation, the director is, in good faith, of the opinion that the company has, or in the next 6 months is likely to have, significant liquidity problems.

The law now provides that, for the purposes of both of these duties, a director has reasonable grounds to believe that the company will be able to perform the obligation when it is required to do so, if the director, in good faith, is of the opinion that:

- The liquidity problems are, or will be, a result of the effects of COVID-19 on the company, its debtors, or its creditors; and
- It is more likely than not that the company will be able to pay its due debts on and after 30 September 2021 (or such later date as prescribed by regulations).

The safe harbour period is deemed to have commenced on 4 April 2020 (after the lockdown began), and will end on 30 September 2020. However, the Government can, by regulation, extend the "initial safe harbour period" to 31 March 2021, and can also create a "new safe harbour period" ending no later than 30 September 2021

Debt Hibernation Scheme

Certain entities can make use of the debt hibernation scheme, to enter into business debt hibernation (BDH), for an initial period of one month and up to 6 months.

If an entity is in BDH, it is temporarily protected from the majority of creditors taking action to recover debts, including by way of legal proceedings, enforcement of security and exercising any right to recover property. Those protections are subject to some rights being retained by creditors, including (but not limited to) the rights of a creditor with security over the whole, or substantially the whole, of the entity's property. In practical terms this will mainly be financial lenders, mostly banks, who usually have General Security Agreements in place to secure lending provided to businesses.

The new Schedule 13, inserted into the Companies Act 1993, sets out a prescriptive regime for entities to deliver a notice to the Registrar of Companies of its intention to enter into BDH, to notify creditors, to seek creditors' approval, and other similar provisions.

Much with the safe harbour regime, access to BDH is time limited. Entities may not enter into BDH after 24 December 2020 (or such later date as prescribed by regulations). Finally, all of the provisions relating to BDH will be deemed to be repealed on 31 May 2022.

Putting into Practice

What remains to be seen is how these measures will operate in practice.

For example, the complexity of the debt hibernation scheme makes it difficult to see how many businesses would be in a position to take advantage of the scheme without incurring significant advisory costs owing to the need to establish that the liquidity issues arose as a direct result of the Covid-19 lockdown. In reality, it will only be a small percentage of impaired companies who are able to say this was the primary cause of liquidity issues.

The strength of the safe harbour measures will also only become apparent during any subsequent litigation, by creditors and/or liquidators, against company directors personally which will likely take some years to determine.

However, it may well be the greatest impact of these amendments is fact that they are available to debtor companies and their directors, whether or not they are used. If facing short-term problems, company directors have a far greater tool box available to them to enable a longer term view of business viability; and business debt hibernation provides an alternative against which negotiations with creditors can take place.

Martelli McKegg's insolvency team are able to provide expert and efficient advice about issues facing companies as a result of Covid-19. Please contact Jacque Lethbridge, Bill Gambrill or Mathew Martin if you have any questions.

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