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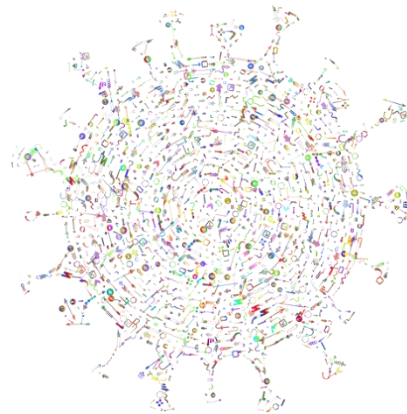

COVID-19 – The Government's response to corporate insolvency

Introduction

On Friday, 3 April 2020, the New Zealand Government announced changes to the Companies Act 1993 (**Companies Act**) aimed at supporting New Zealand businesses through the COVID-19 epidemic. The changes in law are to be applied retrospectively from that Friday. In particular, the changes look to ease the pressure on businesses and directors facing solvency issues so as to avoid companies being placed into liquidation prematurely.

The current position

The Companies Act codifies a number of director's obligations to both the company and the company's stakeholders, including its creditors. When solvency issues arise, the relevant duties include:

- ***Reckless trading (s.135)*** - A director of a company must not:
  - agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or
  - cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors, and
- ***Duty in relation to obligations (s.136)*** - A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

These duties have been the subject of particular focus in recent times following the significant personal liability incurred by the directors in the *Mainzeal* case.[1]

The proposed insolvency changes

While the proposed legislation has not yet been released, we expect to see the following changes:

- A 'safe harbour' for directors from breaches of ss.135 and 136 of the Companies Act where a business continues to trade, or takes on new obligations, over the next six months if:
  - in the good faith opinion of the directors, the company is facing or is likely to face significant liquidity problems in the next six months as a result of the impact of the COVID-19 epidemic on them or their creditors; and
  - 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 the next 18 months (i.e. as trading conditions are likely to improve or they believe that the company is likely to reach an accommodation with its creditors).
- A Business Debt Hibernation Regime allowing a moratorium on the payment of debts. This Regime will be available to trusts, partnerships and certain other legal personalities. For a company to be placed in such a Regime, the directors of the company must:
  - conclude whether they meet the threshold (to be established in the legislation);

[1] *Mainzeal Property and Construction Ltd (in liq) v Yan* [2019] NZHC 255.

- provide notice to the company's creditors that the company is seeking a six-month moratorium on the repayment of its debts (this will trigger an immediate one-month moratorium during which creditors are prevented from taking action against the business to recover their debts);

- the company's creditors will then have one month to vote on whether to accept the six-month moratorium (the threshold, we expect, will be 50% of creditors by number and 50% by value of debt);

- if the requisite majority of creditors agree to the proposal put forward, the proposal will be binding on all creditors (other than employees) and the moratorium will continue for a further six month period (i.e. a total of seven months); and

- any payments or dispositions of property made by a company in Business Debt Hibernation to third party creditors, excluding related parties, may be exempt from the voidable transactions regime if the transaction has been entered into in good faith, on an arm's length basis and without an intention to deprive the company's existing creditors.

The seven-month moratorium will allow the business to continue to trade, and to structure its affairs, to prevent the business from being placed into receivership, voluntary administration or liquidation as a result of the impacts of COVID-19. If the creditors do not approve the moratorium, the directors of a company will have to assess whether the company is in a position to continue trading. Creditors may also enforce their existing rights under the Companies Act if the extended moratorium is not approved.

Other changes

Further to the above, the Companies Act will also be amended to:

- reduce the "clawback" period under the voidable transactions regime to six months (from two years);
- delay the commencement of the 'licensed insolvency practitioners' regime, due to start in June 2020, for up to 12 months;
- allow greater usage of electronic signatures; and
- grant the Register of Companies powers to extend reporting and meeting deadlines imposed on companies by statute.

What hasn't changed?

The duties of a director to act in good faith and in best interests of the Company (s.131) and to exercise powers for a proper purpose (s.133) remain in place and directors seeking to rely on the 'safe harbour' or Business Debt Hibernation Regime must act with these duties in mind. Directors who by false pretences or other fraud induce a person to give credit to the company or carry out a transaction with intent to defraud creditors of the company will remain liable under s.380 of the Companies Act.

There are also no proposed changes to the statutory demand regime. In Australia, in response to COVID-19, a minimum monetary threshold (A$100,000) has been set for issuing statutory demands and the time to respond or comply has been extended to six months.

Summary

These changes will certainly provide some relief companies facing solvency issues in the wake of COVID-19 and its severe economic impacts. We hope to see businesses rely on these changes, continue to trade and make successful recoveries, which otherwise may have been prematurely put into receivership, administration or liquidation. However, directors should not decide to rely on these changes lightly and should carefully assess the decision to continue trading. It will also be essential for directors and boards to carefully document their decisions and frequently reassess their ability to continue trading as the impacts of COVID-19 continue to be felt.

Important: This document does not constitute legal advice to any person. Directors should seek specific advice on their situation and how the COVID-19 epidemic impacts their business and respective obligations to companies.

This document was created on 6 April 2020 and reflects developments as at that date.