Safe harbours for directors' duties and debt hibernation regime during covid-19

On 3 April 2020 the New Zealand Government announced that they are introducing changes to the Companies Act 1993 (**Act**) in order to help provide relief to both individuals and businesses that face financial distress as a result of COVID-19. The goal of these temporary measures is to provide a safety net to help profitable and viable businesses to resume normal operations after COVID-19 has passed.

Following similar measures in Australia and the United Kingdom, the temporary changes provide a safe harbour for Directors in regards to the insolvency measures under the Act, a debt hibernation regime and other administrative changes to help companies continue operations. These changes are welcomed so Directors can make practical decisions to best protect the business rather than facing personal liability and being forced to put companies into liquidation.

Directors' duties – safe harbour

The changes will provide a safe harbour for Directors in regards to their Directors' duties, particularly in respect of reckless trading (s135) and incurring new obligations (s136) under the Act for the next six months if:

- as a result of the impact of COVID-19 the company is facing or is likely to face significant liquidity problems in the next six months;
- 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 the company will be able to pay its debts as they fall due within 18 months.

This safe harbour measure is designed to allow Directors to decide to keep trading and taking on new obligations, provided the business is viable and likely to recover in a reasonable period of time after the COVID-19 pandemic.

Debt hibernation regime

A COVID-19 Business Debt Hibernation regime is being introduced into the Act. This regime is designed to encourage Directors to talk to their creditors early and encourage businesses to continue transacting with other

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businesses, by hibernating debts until the company is able to return to normal trading again.

This regime will have some conditions:

- Directors will have to meet a threshold before being able to use the regime (this threshold is yet to be announced);
- creditors will have one month to decide after a proposal is put to them, with more than 50% of creditors (by value and number) having to agree for the proposal to go ahead;
- there is a one month postponement on the enforcement of debts from the date the creditors are notified of the proposal, and a further six month postponement if the proposal goes ahead; and
- it is subject to a condition that any transactions are entered into in good faith, on arm's length terms and without intent to deprive existing creditors.

This regime will be available to all forms of entities, including those that do not have a legal personality such as trusts and partnerships. However, it does not include insurers, registered banks, non-bank deposit takers or sole traders.

A proposal that goes ahead will be binding on all creditors other than employees, and will be subject to any conditions agreed during the proposal. If the proposal is not accepted by creditors, existing options such as trading on, voluntary administration and appointing a liquidator are still available to companies. Therefore, it is fundamental to be upfront with creditors about the company's position as early as possible in order to get the majority needed.

Practical administrative changes

Further additional changes to the Act have also been announced such as filing and reporting deadlines for all entities are relaxed in respect to corporate governance. This will include holding AGM's and filing annual returns that may not be able to be actioned by their due date, as a result of COVID-19.

It has also been proposed that temporary relief be provided for entities that are unable to comply with obligations under constitutions and rules as a result of COVID-19, by allowing electronic communications to be used even if this is not currently provided for in the constitution or rules.

Limitations

These temporary measures do not allow Directors to act without caution, as the temporary provisions cannot be relied upon outside the normal course of business. Directors must still exercise reasonable care, diligence and skill, and the current duties under the Act such as acting in good faith and taking account the best interests of the company, are still in place.

When acting in the best interests of the company, Directors are under a duty to trade in a manner that does not cause a substantial risk of serious loss to the company's creditors. You may recall this being highlighted in the decision of *Mainzeal Property and Construction Limited v Yan* where the Directors of Mainzeal Property and Construction Limited (**Mainzeal**), were collectively fined NZ$36 million for a breach of the reckless trading duty. For more information on the lessons leant from this case, see **here**, or for more information on when a parent company can be liable for its subsidiaries actions, see **here**.

It is important that Directors take particular care if their company is facing financial difficulty, and if they have any doubt as to the level of compliance required they should seek specific advice.

If your business is struggling as a result of COVID-19, or if you are worried about your personal liability under your position as Director, please do not hesitate to get in touch with the Business Law team at Lane Neave.