

# COVID-19 Safe Harbours and Business Debt Hibernation



## What will it mean for directors?

COVID-19 has created significant liquidity challenges for a number of New Zealand businesses, and this has resulted in many directors, through no fault of their own, finding themselves in control of companies that might not be solvent under existing tests.

With the Government looking to keep businesses operating, and to bridge the gap between director conservatism on trading prospects, and recklessness, our experts hosted a well attended panel webinar and shed some light on what the announced changes really mean for businesses and directors facing into the headwinds brought about by COVID-19. Below are some of the key take-aways from that session.

## Safe Harbour

### Overview

The “safe harbour” regime essentially provides that any director(s) who satisfy the “safe harbour” criteria and elect to continue to trade over the next six month period will not be in breach of certain duties under the Companies Act. Specifically, such decision to continue to trade will not be considered as recklessly trading (section 135) or incurring obligations that they are not able to meet (section 136). The announced criteria for accessing the safe harbour regime is:

- **COVID-19 causation:** 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;

- **Historical liquidity:** the company was able to pay its debts as they fell due on 31 December 2019; and
- **Forecast liquidity:** acting in good faith, the directors consider 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's important to note that although the Government's announcements primarily focus on sections 135 and 136 of the Companies Act, directors' other core duties (such as the duty to act in good faith and in the best interests of the company) still need to be discharged.

## What does it mean for directors?

While there will be hard decisions for directors to make in the near future, the announcements should provide prudent directors of COVID-19 affected businesses, who choose to trade through the current period, with some degree of comfort. In order for those directors to form their “good faith opinion” in relation to liquidity we expect that their businesses will, at a minimum, be required to:

- Prepare both short term and long term cashflow forecasts;
- Stress test those short and long term forecasts for different scenarios to see what impact that has on the ability to continue trading;
- Revisit frequently, perhaps weekly, those short and long term forecasts against what actually transpires and reforecast in the event the actual position and the forecast don't align;
- Talk to creditors so that there is no confusion about payment expectations, and they understand the company's position and plans;
- Document the rationale supporting decisions;
- Consider the availability of the various government, bank subsidy and loan schemes; and
- Seek professional advice to assist management and the Board

In addition to the above, in order to avail themselves of the ‘safe harbour’, directors should consider and document that they were able to pay their debts as they fell due on 31 December 2019 (and the basis for that view).

## Business Debt Hibernation regime

### Overview

The Business Debt Hibernation regime allows businesses impacted by COVID-19 to place their existing debts into hibernation until they are able to resume trading at normal levels. As noted in our recent publication, the key features of the regime are that:

- Directors will have to meet a “threshold” before being able to access the regime and put a proposal to their creditors. This threshold is still to be defined.
- Once a company is eligible for the Business Debt Hibernation regime, it will be able to put a proposal to the company's creditors, with the proposal only able to proceed if a minimum of 50% of creditors (both in number and value) agree.
- If a company meets the threshold and submits a proposal to creditors, it will have a one month moratorium on the enforcement of debts from the date its creditors are notified of the proposal, with a further 6 month moratorium if the proposal is passed by the creditors.
- Any further payments, or dispositions of property, made by the company to third party creditors would be exempt from the voidable transactions regime, meaning that a liquidator would be unable to “claw back” the payment should the company go into liquidation at a later date. This exemption would be subject to a condition that the transaction was entered into in good faith by both parties, on arm's length terms and without the intent to deprive the existing creditors of the company.

## What does it mean for directors?

Whether creditors support a proposal is likely to come down to whether they trust the company to meet the terms of the proposal and whether they believe that is better than the alternative options, such as liquidation.

Like all compromise arrangements, getting the right advice and guidance before starting the process to utilise the Business Debt Hibernation rules is crucial. In particular:

- Any proposal that a company puts to creditors, including under the Business Debt Hibernation regime, should be robust and based on reasonable assumptions.
- The Business Debt Hibernation proposal should outline how the directors intend to meet any overdue creditors at the date the proposal is made – which will likely include a deferred payment element and/or a compromise of the amount that each creditor receives in total.
- Directors who are considering entering the Business Debt Hibernation regime will need to ensure that they are confident the company can meet the terms of any proposal, as well as ensuring it can service any new debt the company expects to incur after the proposal has been accepted. Cashflow forecasting and scenario testing will be key to ensuring a director can be confident that they are acting reasonably in being able to meet ongoing obligations and meet the terms of the proposal.
- Directors should be opening up a dialogue with their creditors now, particularly if they think they may have to rely on this regime when it comes in.
- Directors need to be conscious that there will likely be a need for some quite full financial disclosure to creditors in order to put a proposal to creditors, so should prepare for disclosure of assets and liabilities, and forecast cashflows.
- The regime is intended to deal with debts that arise due to COVID-19, which would not otherwise have arisen. It may therefore not be suitable for all circumstances. Directors should be clear on what they need to achieve and seek advice on that as there may be other more effective options available.

## Timing and next steps

Unlike the wage subsidy regime, these changes require legislative amendment. With Parliament reconvening on 27 April and broad cross-party support, we expect these changes, together with the other Government interventions (including those announced on 15 April (tax loss continuity and carry-backs) to be early on their agenda. Some of these changes and interventions, including the “safe-harbour” regime, are intended to have retrospective effect, and our view is that directors can reasonably rely on the announcements in advance of them becoming law.

There is still a lot of detail to be worked through, and the position of related party creditors, guarantees, secured creditors and “ipso facto” clauses (essentially termination clauses triggered by insolvency procedures) in the Business Debt Hibernation regime is still unclear. Various options and methods of providing transparency and fairness are being considered, including excluding related parties from having voting rights, excluding holders of a General Security Agreement from the regime, or limiting the regime to only debt that is overdue at the date of the proposal. The detail in the legislation will be critical in how successful the regimes are, and we’re working with the Government in this regard.

**If you have any comments or questions please get in touch with one of our team and we would be happy to ensure that it is considered by MBIE.**

### John Fisk

Partner  
+64 21 492 052  
john.fisk@pwc.com

### Marcus McMillan

Director  
+64 27 511 6608  
marcus.j.mcmillan@pwc.com

### Tom Logan

Partner, PwC Legal  
+64 27 531 9282  
tom.x.logan@pwc.com

### Matt Keenan

Partner, PwC Legal  
+64 21 834 216  
matt.p.keenan@pwc.com

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