



Companies Act Changes



On Friday 3 April 2020, the Government announced temporary amendments to the Companies Act to enable businesses facing solvency issues as a result of COVID-19, to continue trading. The key changes are to:

- Introduce a 'safe harbour' regime to protect directors from insolvency claims under s135 and s136 of the Companies Act; and
- Give businesses the ability to place existing debts into hibernation, until the business can return to normal trading.

The draft legislation is expected in the coming weeks when the finer details of the regime should be clarified. Further details on the proposed changes are available on the Companies Office website [here](#).

Background

Many well governed businesses that were previously stable, or even thriving, are now facing severe liquidity constraints. This may mean they are unable to pay debts as and when they fall due. Forecasting a company's prospects is extremely difficult in this environment, making evaluation of future solvency (being able to pay debts when due) very difficult. Trading a business while it is insolvent exposes a company's creditors to a risk of loss. Under s135 and s136 of the Companies Act directors must not:

- allow the company to trade in a manner likely to create substantial risk of serious loss to the company's creditors (i.e. trade whilst insolvent); and
- not incur an obligation unless they believe the company will be able to perform the obligation when required to do so.

This is a key duty of directors and breaching these provisions can lead to personal liability for directors for the business's debts. Given the current liquidity constraints, many directors will be concerned around their personal exposure from continuing to trade. The Government has announced the safe harbour and business debt hibernation schemes to allow business owners to keep businesses alive and explore restructuring options to remain viable.

We consider these changes will be a welcome relief for many boards. It follows the implementation of similar relief regimes in Australia and the United Kingdom.

A brief summary on the different proposals is contained below:

Safe Harbour regime

Under the safe harbour regime, over the next six months, directors who decide to keep trading will not breach their duties 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 important to note that directors cannot disregard the consequences of trading and must act in good faith. The regime does not provide assistance to those businesses that were already marginal. The Australian safe harbour regime requires the company to keep and maintain appropriate financial records and to closely monitor the financial position of the business. We would expect similar requirements in New Zealand.

The amendments are intended to encourage honest, diligent and competent directors to keep their business alive and formulate a plan to work through the liquidity crisis. If the board subsequently consider that there is no reasonable prospect of being able to return to solvency, then the board will need to consider whether other restructuring or insolvency options should be used, (i.e. business debt hibernation, compromises, voluntary administration, or liquidation).

Boards that are facing insolvency and consider they can utilise the proposed safe harbour provisions will need to carefully consider whether they comply with the requirements, and evidence the good faith requirements.

At a minimum, we consider that boards will need to prepare:

- short term cashflow forecasts that show how they can manage existing cashflow requirements;
- a robust 18 month forecast based on reasonable and supportable assumptions;
- a plan to manage liquidity and creditors, including any increases in creditors during the period;
- a restructuring plan that sets out opportunities to reduce costs, improve cashflow and strengthen the balance sheet;
- a communication plan to address any required agreement and reporting requirements for key stakeholders; and
- a governance process to monitor the financial position and properly record key decisions regarding ongoing trading.

Boards may also want to consider seeking professional advice from lawyers and their accounting advisors to provide an objective view on options and compliance with the safe harbour regime.

Business Debt Hibernation

The business debt hibernation scheme is intended to be a simple, self-help regime for companies to place existing debts in hibernation. The key features are:

- it applies to companies, partnerships, trusts, incorporated societies **but not** licensed insurers, registered banks, or non-bank deposit takers;
- an as yet unstated threshold must be met before using the Business Debt Hibernation regime to put a proposal to creditors. It appears likely the key requirements will be that the business was solvent prior to COVID-19, there is a reasonable prospect of returning to solvency and the proposal is in the best interests of creditors;
- creditors will have a month from notification to vote on the Business Debt Hibernation proposal.
- 50% (by number and value) must agree for it to proceed. The proposal then becomes binding for all creditors (other than employees) and subject to any conditions agreed with the creditors;
- there will be a one-month moratorium on debt enforcement from notification of the proposal and a further six-month moratorium if the proposal is passed; and
- While in hibernation, payments to creditors (except related parties) cannot be unwound as a voidable transaction.

This regime is likely to be extremely useful for otherwise viable businesses that need time to formulate a restructuring proposal. Key areas for consideration and where further detail is required will be:

- whether creditors must be categorised into classes;
- the rights of secured creditors with security over substantially the whole of the property;
- whether the company can also compromise creditor debts through this process, or whether they have to use a part 14 Compromise to achieve this;
- rights for creditors to challenge the process;
- the information and documentation requirements to provide to creditors to support any proposal; and
- whether the regime will include any relief measures to prevent creditors relying on 'ipso facto' clauses to terminate contractual agreements as a result of an organisation proposing a business debt hibernation.

Businesses may look to use the hibernation regime to provide a moratorium and a creditors compromise to reduce the debt burden for the business. It is also the case that in some situations, an insolvency event (Voluntary Administration, Receivership or Liquidation) may still be the best approach in terms of salvaging value and minimising risk for directors and the creditors.

Contact Us:

Leon Bowker | Director, Deal Advisory

T: +64 9 367 5333 | **E:** lbowker@kpmg.co.nz

Alton Pollard | Director, Deal Advisory

T: +64 9 363 3234 | **E:** altonpollard@kpmg.co.nz

Luke Norman | Director, Deal Advisory

T: +64 4 816 4865 | **E:** lnorman@kpmg.co.nz

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