# Safe Harbour and Business Hibernation Scheme – One Year Later

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In April last year, while in the depths of a nationwide level 4 lockdown, Finance Minister, Grant Robertson, announced some incoming key changes to the Companies Act 1993 (‘**Act**’). The purpose of these changes, otherwise known as the Safe Harbour and Business Debt Hibernation Scheme (‘**BDH**’), was to support companies, trusts and other business entities that were at risk of facing insolvency as a resultof COVID-19.

Just days after the announcement, there was an influx of articles from countless professional services firms (including us) outlining what these changes were and the likely implications.

It has been one year since these changes took effect in May 2020 and it looks like the scheme never really took off.

While the safe harbour period for company directors expired inSeptember 2020, BDH is still in effect until 31 October 2021.

Should there be further lockdowns, in this article we revisit the basics of the BDH Scheme and discuss possible reasons behind its low participation rate, despite there being so many businesses that were (and still are) going through financial difficulties as a result of thepandemic.

While the BDH Scheme was available to trusts, partnerships and other business entities, this article focuses more on businesses being run by a company structure.

## Safe Harbour

The safe harbour temporarily allowed the relaxation of some key director duties under the Act for company directors facing significant liquidity issues as a result of the pandemic. Those duties were:

1. the duty to avoid reckless trading (section 135 of the Act); and
2. the duty to avoid incurring an obligation when the director does not believe, at that time, on reasonable grounds, that the company will be able to perform the obligation (section 136 of the Act).

This essentially provided directors with a defence to any claim brought against them by a liquidator or creditors alleging breach of those duties, if the directors could show that:

1. at the time, they believed in good faith that the company was facing, or was likely to face, significant liquidity issues in the next six months as a result of the impact of COVID-19 on the company or their creditors;
2. the company was able to pay its debts as they fell due on 21 December 2019; and
3. while acting in good faith, the directors considered that it was more likely than not that the company will be able to pay its debts as they fall due within 18 months.

The safe harbour (and BDH) were never a 'get out of jail free' card. Directors were still obligated to meet the rest of their director duties under the Act (such as the duty to act in good faith and in the best interests of the company; the duty to exercise their powers for a proper purpose; and the duty to take care). Additionally, during this time, there were even more key considerations for directors to take on.

While the safe harbour period has now expired, we predict that recently appointed liquidators, when investigating a company's affairs, will be closely considering whether the safe harbour protections properly apply if it appears there are breach of duty claims against the director(s). If our prediction is correct, it would be interesting to see how this may affect the D&O insurance market.

## Business Debt Hibernation Scheme

BDH allows qualifying business entities the option of notifying creditors of an intention to put forward a proposal that the company be placed into business debt hibernation. Creditors then have one month to vote on the proposal after being notified.

By default, during this one-month voting period, creditors are not allowed to enforce debts by, for example, commencing litigation or repossessing stock. This protection period is known as a 'moratorium period' and takes effect from the date of notification.

If 50% of creditors (by number and value) agree, this moratorium period can be extended for a further six months.

It should also be noted that, a company opting for BDH does not:

1. trigger an event of default in any loan or security agreements; and
2. cannot be used as evidence that the company is unable to pay its debts or is insolvent.

During the moratorium period, directors also still retain control of the company and can continue trading subject to any restrictions agreed on with creditors.

## Why hasn't the BDH Scheme taken off?

Despite BDH being quite attractive on paper, at least for directors, the reality is that it has gained a lot less traction than anticipated.

We think that this is, in large, probably due to New Zealanders being generally supportive and co-operative with one another, especially during the earlier months of COVID-19. This was further encouraged by other forms of readily available government support, such as the COVID-19 Wage Subsidy.

Low participation rates could also partly be attributed to the administrative burden around BDH's entry mechanisms, more specifically, its threshold requirements and application process; paired with very few additional practical benefits for all parties involved.

## Procedure and processes to entry

Mirroring the safe harbour requirements above, entry into BDH requires that:

1. the board of directors must resolve that, as at 31 December 2019, the company was able to pay its debts as they fell due in the normal course of business;
2. at least 80% of the directors must vote in favour of entering into BDH;
3. each director who votes in favour of the regime must make a statutory declaration, stating:
    a. that the entity was able to pay its debts as they fell due, as at 31 December 2019;
    b. that they hold the opinion, in good faith, that:
        i. the entity has, or in the six months is likely to have, significant liquidity issues;
        ii. the liquidity issues are or will be a result of the effects of COVID-19 on the entity, its debtors or creditors; and
        iii. it is more likely than not that the entity will be able to pay its due debts on or after 30 September 2021; and
    c. the grounds for each good faith opinion, declared as above.

## Procedure and processes to apply

Then, there's the application process.

To begin, protection under BDH must be initiated by a prescribed notice to the Companies Registrar.

All creditors must each be provided with:

1. a copy of the above notice;
2. a copy of the above statutory declaration;
3. a high-level description of the business's proposed arrangement to its creditors;
4. a list of all creditors, setting out
    a. the amount owing or estimated to be owing to each creditor;
    b. the total amount owing or estimated to be owing to the creditors; and
    c. the number of creditors.
5. contact details in case creditors have any queries,

Some of this information can be found under the documents tab in a Companies Office search.

Next, a second notice must be sent out to creditors not less than 5 working days before the creditors' vote. The second notice must be highly prescriptive and set out the final proposed arrangements between the directors and creditors.

During the 6 month moratorium period (if agreed upon), a creditor may request that the declaration be refreshed and reissued. If such request is made, directors have only 5 business days to prepare and reissue a new statutory declaration.

## Overall cost > benefit

The regime's harsh penalties probably also had something to do with low participation rates.

For instance, if directors do not refresh and reissue a statutory declaration upon a creditor's request, the protection provided by the agreed moratorium period immediately ceases. If a board of directors fails to comply with the steps required for the application process, every director is at risk of a fine of up to $10,000 each. Particularly during a recession, this is not a risk many are willing to take.

Directors were also strongly urged to consult with professional advisors before entering into BDH. With the risk of being subject to such harsh penalties, this is hardly surprising. However, seeking professional advice would, of course, come with further financial cost; a cost which many were not prepared to fork out given the circumstances.

Lastly, other relief arrangements were still available and, arguably, more attractive.

For example, the BDH Scheme does not reduce the amount of debt owed to creditors. It only relaxes and prolongs the repayment period. A creditor's compromise, on the other hand, would have given entities and creditors the opportunity to reduce the debts owed.

Voluntary administration ('**VA**') may have also been preferable to BDH because VA perhaps strikes more of a balance between the interests of the company and creditors. While directors remain in office under VA, an independent insolvency practitioner takes over the running of the business. Having an independent professional considering the future of the business and making recommendations is often welcomed by creditors if there are concerns about director mismanagement. In contrast, BDH is much more burdensome on directors, and creditors' interests are treated secondary. If creditors are concerned about the directors' handling of the company's affairs, they are unlikely to agree to an extended moratorium period while the directors remain in control.

It is probably fair to assume that some companies used BDH as a means of delaying and frustrating creditors when their financial position was hopeless. However, if a company has good relationships with its creditors and can reach payment arrangements informally, the directors probably won't need to utilise a formal procedure like BDH or VA.

While the BDH Scheme continues to be in force until 31 October 2021, for the reasons outlined above, we predict that participation rates will remain relatively low. With that said, if there are continued challenges securing products because of supply chain issues, or if costs bite in the near future due to inflation, we might see slightly more businesses in BDH.