



Guidance for New Zealand companies in financial distress

*For accountants
in public practice*

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Businesses in New Zealand are facing challenging times and, as accountants, you will have clients coming to you seeking advice and looking for options in relation to various levels of financial distress, either current or expected. This guidance will outline some of the options available as part of the relief measures introduced by the New Zealand Government around insolvent trading laws in the Companies Act 1993.

With the COVID-19 Alert Level 4 lockdown announced on 25 Mar 2020, New Zealand businesses face unprecedented financial pressure, with a very real possibility that directors might place their companies into liquidation prematurely, based on the perception that to continue to trade in these uncertain times would result in them being held personally liable under 135 and 136 of the Companies Act.

These insolvency related director duties are designed to prevent directors from trading recklessly and also incurring obligations unless they reasonably expect that they can meet these obligations.

Given the current uncertainty and clear inability to make a reasonable assessment in terms of these duties, the Government has provided much needed assistance for the economy and introduced relief measures designed to ease the rules around trading in insolvent circumstances.

First and foremost: your client must understand their financial situation

Your client should be proactive in assessing their current situation and taking practical and proactive measures. Understanding their cash position is key! There are important steps that directors must take in order to protect themselves and give their company the best opportunity to survive.

Assess the resources available to your client – get them to:

- Talk to their suppliers and customers immediately
- Understand their short-term commitments
- Get their financial records in order
- Check their contracts, leases and insurance policies to see what cover and options are available and what their obligations are

- Keep accurate and up to date records
- Document all steps taken
- Communicate with their bank and find out what assistance they qualify for.
- Review and avail themselves of the many government stimulus and rescue packages
- Investigate tax pooling options
- Seek help from a trusted professional advisor - see our recommendation later in the piece.
- Develop an action plan
- Review and modify it on an ongoing basis

What relief measures are available?

On 3 Apr 2020, the Government announced the introduction of legislation to the Companies Act (1993) providing relief measures to businesses facing insolvency as a result of COVID-19.

The measures fall into 3 categories:

- 1 Temporary changes to insolvency law and directors' duties, which are aimed at increasing the survival prospects for businesses that were profitable at the start of COVID-19.
- 2 Temporarily extending deadlines imposed on companies, incorporated societies, charitable trusts and other entities under legislation and entities' constitutions e.g. statutory deadlines for holding Annual General Meetings.
- 3 An amendment to the Contract and Commercial Law Act 2017 allowing the use of electronic signatures where necessary due to COVID-19 restrictions

Safe Harbour

The first of the temporary measures, under point 1 above, is designed to relax the insolvent trading sections of the Companies Act by amending sections 135 and 136 to provide protection to directors from these duties.

For a 6 month period, directors' decisions to keep on trading and taking on new obligations will not result in a breach of directors' duties if:

- In their good faith opinion and acting in good faith, the company is facing or is likely to face significant liquidity problems in the next six months as a result of COVID-19;
- The company was able to pay its debts as they fell due on 31 December 2019; and
- They 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 may be because trading conditions are likely to improve or they are likely to be able to reach an agreement with their creditors.

It is important for directors to note that this does not give them a free pass. If the company was insolvent as at 31 December 2019 and they are not able to formulate a reasonable business rescue plan to continuing trading the business after the crisis, then the directors will need to cease trading or risk personal liability for breach of their duties.

The safe harbour protection will not be available to licensed insurers, registered banks and non-bank deposit takers, on the basis that these entities are regulated by the Reserve Bank of New Zealand.

Business Debt Hibernation scheme (BDH)

The second measure is designed to give a company short term relief from their debts and is an amendment to the compromise provisions of the Companies Act. This is essentially a hybrid of voluntary administration (Part 15A of

the Companies Act) and the compromise regime (Part 14 of the Companies Act), noting that the only relief available is the six month moratorium on the enforcement of debts.

While a business is in BDH, it will be able to continue to trade, subject to any agreed restrictions with its creditors.

The key points of the scheme are as follows:

- Encourage early discussion between directors and creditors;
- Once a proposal has been provided to creditors, creditors have one month from the date of notification of the proposal to vote. The proposal will be deemed accepted if 50% in value and number support it;
- An accepted proposal will be binding on all creditors other than the businesses employees;
- From the date the proposal is notified, there is a one month moratorium on the enforcement of debts in place, and a further six month moratorium if the proposal is passed;
- If a proposal is rejected, directors still have the options of trading on, entering into voluntary administration or appointing a liquidator;
- The scheme allows directors to retain control of the company, rather than control being passed to an insolvency practitioner;
- Provides creditors with certainty that payments received for ongoing supply will not be subject to being challenged at a later date, unless the transactions occurred in bad faith.
- Intended to be quick, simple and flexible.

Directors will have to meet a threshold before being able to access the Business Debt Hibernation regime.

The scheme will not apply to the following:

- Sole traders
- Licensed insurers, registered banks and non-bank deposit takers.

The Companies Office website will have a fill-in-box form that entities will be able to complete in order to make the proposal to their creditors.

How businesses will access the insolvency relief, and the requirements they will need to satisfy, are currently being finalised. The Companies Office and Business.govt.nz websites will also provide further advice and guidance to both directors and creditors.

Other changes to insolvency law will also be made which will:

- Relax the voidable transactions regime (which allows liquidators to claw back payments made to creditors before the commencement of a liquidation) by reducing the period of vulnerability from 2 years to 6 months.
- Provide the ability to defer licensing for up to 12 months

In addition to the above, the Government has introduced a significant number of business packages and relief measures since the outbreak of the pandemic such as the COVID-19 Economic Response Package, the Business Continuity Package, mortgage deferrals, rent increase freezes.

What are the next steps if this can't save the business?

If there is no reasonable prospect of a company recovering from the current circumstances, it should appoint a liquidator as soon as possible to avoid the debt increasing even further.

Once a company has determined that there is no viable business to save and a liquidator is appointed, they will immediately take control of the business and the process moving forward. The liquidator acts for the creditors. They will recover available assets, investigate the company's affairs and distribute any available funds to creditors. Liquidators will also investigate the decisions taken by the directors in the lead up to the liquidation, and directors can be held responsible to compensate the company for matters such as breaches of directors' duties, insolvent trading or unreasonable director related transactions.

Liquidators may also sell a viable business. However it is important to recognise that sale of business options in any form of formal appointment may be limited in a distressed economic environment.

Difference for SMEs & large businesses

In a practical sense, the main difference is the size of the response to distress. Engaging a restructuring or insolvency professional doesn't need to be onerously expensive if your client is an SME. Indeed, many insolvency and turnaround professionals work in small to medium sized firms themselves.

Be careful about who you turn to for specialised advice

When your client's business is in financial distress, it can be tempting for them to put their head in the sand but this is definitely a time for quick and decisive action. Putting this off will only make matters worse and limit the options that are available to your client in the long run.

Many "advisors" may approach your client at this time offering quick fix solutions or they may see their adverts pop on Facebook or Google promising cheap and easy measures to make the problem go away.

CA ANZ and RITANZ stress strongly that there are some unqualified advisors out there under the guise of experienced, knowledgeable and "approved" insolvency practitioners or advisors. Choosing the right person to assist your client in these difficult times is a critical decision.

The key way to know for sure if an advisor is reputable and will have their best interests at heart, is to ensure that they are listed as an 'Accredited Insolvency Practitioner' on the RITANZ or CA ANZ websites as per below. It is important that your clients are placed in the hands of an experienced practitioner, not just for themselves but also to ensure that you fulfil your own obligations as a professional advisor, particularly given the financial stress the clients may find themselves in. Accredited Insolvency Practitioners are held to high professional and ethical standards.

Financial distress can be tough emotionally

Alert Level 4 has been an unprecedented situation and unimaginably frightening for most individuals, especially directors of companies who have employees to care for, bills to pay and creditors chasing them for payments.

This is not a time to try to tough it out emotionally. Know that we are all in this together and you are not alone in feeling the extreme levels of stress, fear and anxiety.

If the load becomes too great, please reach out to friends and family (remotely of course) or the number of helplines available for individuals struggling with difficult emotions.

During the COVID-19 pandemic, the Employee Assistance Program (EAP) will be available to Australian and New Zealand members of CA ANZ. This confidential program supports you and members of your family through counselling services and can be accessed 24 hours, seven days a week. As a member of CA ANZ, up to three sessions are provided free of charge. EAP services provide short-term, early intervention and solution-focussed support from independent professionals, such as counsellors and psychologists. Call EAP New Zealand on 0800 327 669 (NZ).

Our guidance document will hopefully provide some clarity around the relief measures that have been introduced and the resources that are available to business owners in NZ.

Useful links:

- 1 <https://www.ritanz.org.nz/>
- 2 <https://www.charteredaccountantsanz.com/find-a-ca>
- 3 <https://www.mentalhealth.org.nz/>
- 4 <https://www.charteredaccountantsanz.com/member-services/mentoring-and-support/ca-wellbeing>

The information in this guide is current as at 20 April 2020.

This guide has been prepared by RITANZ for CA ANZ and includes content originally published by ARITA in Australia and has been adapted for the New Zealand context with their permission.

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