MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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COVERSHEET

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List of documents that have been proactively released		
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Information redacted **NO**

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In Confidence

Office of the Minister of Finance
Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Business Committee

Extending COVID-19 business debt hibernation scheme

Proposal

1 This paper seeks authorisation for submission to the Executive Council of the Companies (COVID-19—Business Debt Hibernation) Regulations 2020 (BDH Regulations).

Executive Summary

2 On 15 May 2020, the *COVID-19 Response (Further Management Measures) Legislation Act 2020* (FMM Act) received Royal Assent. That Act amended the Companies Act 1993 to allow otherwise viable businesses, but for COVID-19, to access to the business debt hibernation (BDH) scheme.

3 The ability for entities to enter into BDH will end on 24 December 2020, unless extended by regulation. We are proposing extending the BDH scheme for three main reasons:

3.1 Extending the scheme is within the statutory purposes;

3.2 There is no evidence that BDH is causing harm to creditors; and

3.3 BDH is likely to be a useful tool for entities in the coming months, and extension will enhance the integrity of corporate insolvency law.

4 In this context, we are seeking agreement to submit the BDH Regulations to the Executive Council. Those regulations have the effect of extending:

4.1 the ability for entities to enter into BDH from 24 December 2020 to 31 October 2021; and

4.2 the date by which businesses must be satisfied that they will be able to pay their debts as they fall due from 30 September 2021 to 31 July 2022.

Policy

5 The insolvency law system aims to incentivise the rehabilitation of otherwise viable businesses that are temporarily going through a difficult period, and the early liquidation of failing businesses. Rehabilitation can preserve the value of a business and avoid other economic and social costs, such as employees losing their jobs. Early liquidation minimises losses to creditors.

6 The FMM Act amended the *Companies Act 1993* to temporarily put in place the BDH scheme. BDH allows businesses affected by COVID-19 disruptions to place their existing debts on hold for up to seven months.

Why BDH was introduced

7 When the BDH scheme was introduced there were concerns that otherwise viable businesses were facing significant financial pressure, as a result of the impacts of COVID-19. The directors of these businesses were facing a choice between:

7.1 trying to continue trading as normal;

7.2 liquidating, or de-registering;

7.3 entering into voluntary administration; or

7.4 negotiating a compromise with their creditors (e.g. writing off some of the money they owe).

8 BDH was put in place to provide those directors with time to talk to their creditors, and to understand their trading environment before making these decisions.

9 The key features of the BDH scheme are:

9.1 The directors of a business wishing to access BDH can only do so if they are, among other things, of the good faith opinion that:

9.1.1 the entity has, or in the next 6 months is likely to have, significant liquidity problems;

9.1.2 the liquidity problems are, or will be, a result of the effects of COVID-19 on the entity, its debtors, or its creditors; and

9.1.3 it is more likely than not that the entity will be able to pay its due debts at a certain date.

9.2 A moratorium on the ability of a business' creditors to take enforcement against it (e.g. to appoint a receiver or apply to the High Court to appoint a liquidator).

9.3 Where a business wishes to remain in BDH for longer than the initial one month (for a maximum of seven months in total) it must obtain the agreement of more than 50 per cent (by number and value) of its creditors. This agreement can be subject to an arrangement with creditors, designed to address the liquidity problems faced by the business.

9.4 It is a temporary status designed to encourage businesses and creditors to work together on more enduring solutions.

9.5 It is designed to be used by business of all sizes, and is supported by guidance to make it more accessible to small and medium-sized enterprises.

The economic environment indicates an ongoing need for BDH

10 New Zealand's gross domestic product fell by 12.2 per cent in the June quarter. We would ordinarily expect such a contraction to be accompanied by an increase in the number of liquidations, however the number of liquidations in the same period was lower than in the previous year. It is not possible to be certain, but we anticipate this is because of a combination of the factors set out below:

10.1 Tax debt is the most significant driver of insolvency in New Zealand. This year Inland Revenue has aligned itself with the Government's approach to economic recovery from the impact of COVID-19. They have given businesses that temporarily find themselves insolvent, more time and assistance to restructure their affairs.

10.2 Larger creditors, such as banks, do not currently wish to be seen to take the first step against smaller businesses for reputational reasons.

10.3 There have been practical difficulties with taking enforcement actions through the High Court while the country, or parts of the country, have been at Alert Levels 3 and 4.

10.4 Government support measures, such as the Small Businesses Cashflow Loan Scheme and the COVID-19 Wage Subsidy have had the effect of:

10.4.1 Providing many businesses with the necessary short term liquidity to meet their immediate obligations; and

10.4.2 Reducing the pressure on creditors which has increased their tolerance for late payment by their debtors.

11 We do not expect the degree of creditor restraint to continue. In addition, some government support measures have ended or will end soon. The combined effect of these factors will mean that directors will need to consider whether their businesses continue to be viable. We consider that the continued availability of BDH will help directors to make these decisions in consultation with their creditors.

Criteria for extending the BDH scheme

12 The ability for businesses to enter into BDH will end on 24 December 2020.

13 Under section 395B of the Companies Act, this date can be extended by regulations made on the recommendation of the Minister of Finance and the Minister of Commerce and Consumer Affairs (Joint Ministers).

14 In deciding whether to make such a recommendation, the FMM Act states that Joint Ministers must have regard to:

14.1 The purposes of the BDH scheme;

14.2 The effect of the regulations on:

14.2.1 The creditors of entities that have significant liquidity problems; and

14.2.2 The integrity of corporate insolvency law.

15 Each of these criteria is discussed below.

Extending the scheme is consistent with the statutory purposes

16 The purposes of the BDH scheme, as set out in clause 1 of Schedule 13 of the Companies Act, are to:

> *(1) … provide for the business, property, and affairs of [a business] that is facing significant liquidity problems, or [a business] that may in the future face such problems, because of the effects of the outbreak of COVID-19 to operate in a way that—*
>
> *(a) maximises the chances of the [business], or as much as possible of [the business], continuing in existence; or*
>
> *(b) if it is not possible for the [business] to continue in existence, results in a better return for [its] creditors and members than would result from an immediate liquidation of the [business].*
>
> *(2) … give [a business] referred to in subclause (1) some temporary protections relating to its debts in order to give it an opportunity to develop, with its creditors, a longer-term approach to its liquidity problems.*

17 We consider that an extension of the BDH scheme to 31 October 2021, and the date by which businesses must be satisfied that they will be able to pay their debts as they fall due to 31 July 2022, is consistent with these purposes.

18 Some businesses will continue to experience significant liquidity problems due to the ongoing effects of COVID-19, as discussed in paragraphs 10 to 11 above. Extending the BDH scheme will mean that those businesses will have a statutory framework to negotiate solutions with their creditors. This will increase the chances of viable businesses continuing in existence. This is better for individual businesses, their employees, creditors, and the wider economy.

The effect of an extension on the creditors of entities that have significant liquidity problems

19 We do not consider that extending the date businesses can access the BDH scheme will have a detrimental effect on the creditors of businesses that may use it, as:

19.1 A business cannot remain in BDH for more than a month without the consent of a majority (by both number and value) of its creditors. This provides a significant constraint against the misuse of the scheme. In over 60 per cent of cases (as at 4 November 2020), creditors have exercised their rights to prevent a business from remaining in BDH after the expiry of the initial one month period.

19.2 In the absence of BDH, if a creditor were to take legal action against a business facing liquidity problems, there is no guarantee that they would receive all or any of the amounts they are owed in an eventual liquidation.

19.3 Any payment to creditors would also be delayed by the need to appoint a liquidator and complete the liquidation process. Because of the time constraints of the liquidation process, creditors are unlikely to receive their money any faster than if a business successfully used BDH and was able to recover. Businesses can also only enter BDH if they are satisfied with their ongoing liquidity beyond the scheme period. For this reason, BDH will not necessarily materially delay payment to creditors and can act as a useful alternative to the liquidation process.

The effect of an extension on the integrity of corporate insolvency law

20 Before the introduction of BDH, there was no option for businesses which gave them:

20.1 the benefit of a moratorium against enforcement;

20.2 allowed them to retain control of their business while the process was completed; and

20.3 did not automatically result in the liquidation of the company if it was not successful.

21 BDH provides a useful alternative for businesses. It is tailored to the current and foreseeable circumstances, in ways that the existing restructuring mechanisms in the Companies Act do not provide. It provides businesses with time to work through their options and determine whether any of the other options for continuing might work – for example, compromises.

22 We consider that extending both the BDH scheme to 31 October 2021, and the test for long term viability to 31 July 2022, will benefit corporate insolvency law as it will be a useful tool for entities in the coming months.

Consequential changes

23 In order to enter into BDH, a business must assess their long term viability. In making this assessment, directors are currently required to consider whether they believe it is more likely than not that the business will be able to pay its due debts on or after 30 September 2021.

24 We consider that, for businesses entering BDH after 24 December, this date should be extended to 31 July 2022. Extending the test for long term viability will ensure that businesses seeking to enter BDH after 24 December are required to be similarly forward-looking to businesses which have already entered BDH.

25 In the absence of this change businesses who enter into BDH after 24 December will need to be certain of their ability to pay their debts much sooner than was required when BDH was first put in place.

26 In our view this change is a necessary consequence of extending the period for businesses to enter into BDH. We are therefore satisfied that the statutory criteria for making this change have been met for the same reasons as for extending period for businesses to enter into BDH (see paragraphs 16 to 22 above).

27 This extension should only apply to businesses who enter BDH after 24 December 2020, to ensure that the grounds on which businesses entered into BDH up to 24 December 2020 remain consistent for those businesses already in BDH.

Timing and 28-day rule

28 Subject to Cabinet's agreement, the BDH Regulations will be submitted to the Executive Council on 30 November 2020. The Regulations will be notified in the Gazette on 3 December 2020, and will come into effect on 24 December 2020. The BDH Regulations must come into effect on 24 December 2020 to ensure the scheme does not expire.

29 It will therefore be necessary to exempt the regulations from the 28-day rule. It was not possible to bring the BDH Regulations to Cabinet earlier due to a combination of the need to assess the impact of COVID-19 on the insolvency system before making the necessary decisions and the delay caused by the election.

30 In any event, we are confident that there is no detriment caused by seeking a waiver of the 28-day rule. The regulations extend an existing scheme and we do not consider that businesses which could use BDH will need time to adjust to its ongoing availability.

Compliance

31 The BDH Regulations comply with the following:

31.1 the principles of the Treaty of Waitangi;

31.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;

31.3 the principles and guidelines set out in the Privacy Act 1993;

31.4 relevant international standards and obligations; and

31.5 the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

32 The statutory considerations under section 395B of the Companies Act for the making of the regulations have been met (see paragraphs 16 to 26 above).

Regulations Review Committee

33 There are no anticipated grounds for the Regulations Review Committee to draw the Orders in Council to the attention of the House of Representatives under Standing Order 319.

Certification by Parliamentary Counsel

34 The BDH Regulations have been certified by the Parliamentary Counsel Office (PCO) as being in order for submission to Cabinet subject to the Joint Ministers having had regard to the matters in section 395B(4) of the Act, and note non-compliance with the 28-day rule.

Impact Analysis

35 A Regulatory Impact Assessment Summary was prepared in accordance with the necessary requirements, as determined by the Treasury.

36 MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Impact Summary prepared by MBIE. The Panel considers that the information and analysis summarised in the Impact Summary partially meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

37 A significant constraint for the Impact Summary is that the analysis is limited to considering if Ministers should extend BDH in accordance with the statutory criteria in the Companies Act, or let it expire. As a consequence of this constraint, the Impact Summary does not identify and assess the complete range of options that could potentially address the issues faced by businesses with liquidity problems due to COVID-19.

38 The analysis is also constrained by limited evidence on the impact of BDH on businesses and creditors in the context of a complex range of policy interventions to address ongoing challenges of the pandemic and its impact on the economy.

39 The decision to implement BDH was exempt from regulatory impact analysis as it was put in place as a temporary measure during the March-May 2020 COVID-19 lockdown.

40 The Panel considers that the analysis in the Impact Summary is sufficient for the proposal to extend BDH to 31 October 2021. This is because it is commensurate with the expected risk and impact based on the available evidence about how the scheme is working for businesses and creditors.

Publicity

41 A media statement will be released following the finalisation of the relevant Cabinet minutes.

Proactive release

42 This paper will be proactively released within 30 business days of decisions being confirmed by Cabinet, subject to any redactions as appropriate under the Official Information Act 1982.

Consultation

Inter-departmental consultation

43 Officials at the Ministry of Business, Innovation and Employment consulted with the Treasury, the Department of the Prime Minister and Cabinet (Policy Advisory Group), the Inland Revenue Department, the Reserve Bank of New Zealand and PCO.

Targeted consultation

44 The proposals contained in this paper have not been publicly consulted on. However, targeted consultation was undertaken with two law firms, the Institute of Directors in New Zealand, the Restructuring Insolvency and Turnaround Association of New Zealand and the New Zealand Bankers' Association (NZBA). Consulted parties were generally in favour of extending BDH.

45 The feedback from banks, received through the NZBA, was mixed. Some banks were concerned that the low take up of BDH suggested it was not effective. They considered the other restructuring tools already within the law meant BDH was not needed. For the reasons set out above, we do not find this view persuasive.

Recommendations

We recommend that the Cabinet Business Committee:

1 **note** that on 3 April 2020 the COVID-19 Ministerial Group agreed to amend the Companies Act 1993 to create the business debt hibernation scheme;

2 **note** that the entities are unable to enter into business debt hibernation from the close of 24 December 2020 if the scheme is not extended;

3 **note** that under section 395B of the Companies Act 1993 the Minister of Finance and the Minister of Commerce and Consumer Affairs are, acting jointly, able to recommend to the Governor-General to extend the availability of the business debt hibernation scheme;

4 **note** that, when recommending to the Governor-General to extend the availability of the business debt hibernation scheme, section 395B of the

Companies Act 1993 requires the Minister of Finance and Minister of Commerce and Consumer Affairs to have regard to:

4.1 the purposes of the business debt hibernation scheme;

4.2 the effect of the regulations on:

4.2.1 the creditors of entities that have significant liquidity problems; and

4.2.2 the integrity of corporate insolvency law;

5 **note** the advice of the Minister of Finance and Minister of Commerce and Consumer Affairs that these criteria under section 395B of the Companies Act 1993 have been met;

6 **note** the recommendation of the Minister of Finance and Minister of Commerce and Consumer Affairs to extend:

6.1 the ability for businesses to enter the business debt hibernation scheme until the close of 31 October 2021; and

6.2 the date by which businesses entering BDH after 24 December 2020 must consider they will be able to pay their debts as they fall due to 31 July 2022;

7 **note** that the Companies (COVID-19—Business Debt Hibernation) Regulations 2020 will give effect to the Minister of Finance and Minister of Commerce and Consumer Affairs’ joint recommendation to extend the ability for businesses to enter the business debt hibernation scheme under the Companies Act 1993;

8 **authorise** the submission to the Executive Council of the Companies (COVID-19—Business Debt Hibernation) Regulations 2020;

9 **note** that the Companies (COVID-19—Business Debt Hibernation) Regulations 2020 come into force on 24 December 2020;

10 **note** that a waiver of the 28-day rule is sought:

10.1 so that the regulations can come into force before the business debt hibernation scheme expires; and

10.2 on the grounds that it is necessary to comply with statutory obligations;

11 **agree** to waive the 28-day rule so that the regulations can come into force on 24 December 2020.

Authorised for lodgement

Hon Grant Robertson
Minister of Finance

Hon Dr David Clark
Minister of Commerce and Consumer Affairs