

Business Debt Hibernation – the lowdown

The 'Business Debt Hibernation' process is one of a number of new initiatives introduced to mitigate the business impact of COVID-19.

What is the purpose of BDH?

The Business Debt Hibernation or BDH process provides an opportunity for businesses facing significant cash-flow problems due to the effects of COVID-19 to get some temporary relief from payments due to creditors.

The process allows time for the business to develop, together with its creditors, a plan to deal with its debts and liquidity challenges.

BDH is targeted at businesses that, but for COVID-19, could pay their debts beforehand, and will be able to do so again, following some temporary debt relief.

BDH is one of a range of measures implemented in the wake of COVID-19 under the Covid-19 Response (Further Management Measures) Legislation Act 2020.

How does BDH work?

When a business commences BDH, it has an initial one month period of protection from creditors' claims while it develops a plan to present to its creditors.

Creditors are given notice of the BDH as well as details of the plan for the business going forward, that ultimately the creditors must approve.

If a majority of creditors approve the plan for the business, the business will then have a further 6 months' statutory protection from creditors' claims.

The plan will typically involve deferring payment of some or all creditors by putting a payment plan in place. It cannot allow for debts to be cancelled, either partly or

fully. The plan needs to be tailored to the circumstances of the individual business.

Is BDH right for my business?

BDH is available for various types of business entities, including companies, trusts, partnerships and incorporated societies.

It is not available to sole traders or to those businesses already in a formal insolvency process such as liquidation or receivership.

To be eligible, an entity's board (or equivalent) may agree entry into BDH if:

- as at 31 December 2019, the entity could pay its debts as they became due;
- at least 80% of directors (or equivalent) vote in favour of BDH;
- each director voting in favour certifies that as at 31 December 2019, the entity could pay its debts as they became due and that in their opinion in good faith:
 - the entity has, or in the next 6 months is likely to have, significant liquidity problems;
 - those liquidity problems are, or will be as a result of, the effects of COVID-19 on the entity, its debtors or creditors; and
 - it is more likely than not that the entity will be able to pay its due debts on and after 30 September 2021 (or any later date prescribed by regulations). For this certificate, directors may have regard to certain matters, including the likelihood of trading conditions improving and the likelihood of a plan with creditors being approved.

If a business may not have been sustainable pre-COVID-19, or its outlook going forward has fundamentally changed, such that deferral of creditor

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payments is ultimately unlikely to help, then BDH may not be appropriate.

Can all debts be "hibernated"?

Wages, salaries and associated deductions (such as for Kiwisaver, child support, student loans) cannot be the subject of "hibernation" in a BDH process, nor can payment arrangements already agreed with the IRD.

Debts incurred after BDH will also be excluded from the process.

How do I start the process?

Once your board (or equivalent) has resolved to enter into BDH and given the necessary certifications, a notice of entry into the BDH process is filed with the Companies Office.

A copy of that entry notice also needs to be sent to all creditors as soon as reasonably practicable, along with notifications including:

- the certificates given by directors for entry into BDH;
- a high level description of the plan or arrangement intended for the business;
- the likelihood that trading conditions will improve and that creditors will approve the plan;
- contact details for enquiries to be made;
- the amount owing (or estimated to be owing) to that creditor.

How does the relief from creditor claims work?

For a period of one month after entering the BDH process:

- creditors are unable to enforce any mortgage or other charges or securities over the entity's property;
- owners or landlords/lessors cannot recover property used by the entity;

- Court proceedings cannot be begun or continued; and
- any enforcement processes are halted.

Note, however, that a creditor with security over all, or substantially all, of the assets of a business (such as a bank with a general security agreement or GSA) is not restricted by BDH from taking steps against the business under its security.

During this one month period, the business should be working with its advisers and creditors to try to develop a plan for the way forward.

This plan to deal with the entity's situation needs to be put before creditors and they have an opportunity to consider it and to vote on it.

If the plan is approved by creditors, then the statutory protections against enforcement can continue for a further six months.

Entities in BDH also receive some relief from the insolvent transactions regime under the Companies Act.

If an entity in BDH enters into a transaction during the relief period (or the transaction is specifically authorised under the plan approved by creditors), provided that the transaction was entered into in good faith and on arm's length terms then that transaction is unable to be subsequently overturned by a liquidator.

Except with Court approval, personal guarantees of the entity in BDH given by directors, shareholders or their relatives also cannot be enforced during BDH.

What does an arrangement with creditors look like?

The proposal to creditors is the plan to get the business back on track and to repay debts in full over time. The plan can defer payment of debts, but it cannot otherwise vary them or cancel them either fully or partly.

This needs to be a credible plan where creditors can see a pathway to being repaid that is a better outcome for them than if the business goes into liquidation.

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From the entity's perspective, the plan needs to make financial sense and be workable.

The plan itself will need to be tailored to the particular business and reflect its circumstances in terms of cash flow, seasonality, and take into account any other measures, such as restructuring, being undertaken by the business.

The input of the entity's accountant, banker and lawyer is likely to be needed in developing the plan.

Commonly, this type of plan might provide for a certain payment to creditors during the period of BDH and deferring other payments over time.

How does the creditor approval process work?

The entity, once in BDH, needs to send a proposal to all of its creditors on which creditors will vote.

The proposal notice needs to be sent at least five working days before the vote is held, and the vote must be held before the expiry of the one month period after entry into BDH.

There are detailed requirements for the proposal notice to be sent to creditors outlining the plan for approval. This includes a list of all known creditors and the amounts owing to them.

While a meeting of creditors can be held in person or by audio or audio and visual communication, a meeting is not required and voting can be held by postal or electronic vote.

How does voting work?

Creditors need to be provided with a detailed description of the arrangement, as well as the wording of the resolution to be voted on and the instructions for voting.

A majority (over half) of creditors in both number and value need to vote to accept the plan for it to be approved.

Related party creditors are unable to vote (for example, a director or shareholder of the entity in BDH, or a related company).

Result of creditor vote

The result of the creditor vote approving (or otherwise) the plan, needs to be filed with the Companies Office.

If the plan is approved, it is binding on the entity and all creditors who received notice of it.

If the plan is voted down by creditors, the entity will lose the BDH protections once the one month period of entering BDH has expired.

An entity is not permitted to enter into BDH more than once (with limited exceptions). This means that if the BDH proposal is not approved by creditors, the entity will need to consider other options.

How does BDH end?

The statutory protections of BDH automatically end at the end of the six month period.

If BDH has been successful and the entity is able to come out of BDH early, it can give notice to do so.

The protections of BDH can be lost if the plan approved by creditors was subject to any condition which has not been materially complied with by the entity in BDH.

BDH also comes to an end if an entity subsequently becomes subject to a formal insolvency process, for example enters voluntary administration, receivership or liquidation, or there is a Court ordered creditors' compromise.

Further help

The Companies Office has published helpful information regarding the BDH process which can be found [here](#).

Any business contemplating BDH should take professional advice. Financial advice will be needed to ensure that the plan being put before creditors is

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achievable for the business and has been stress tested against other options.

Legal advice should be taken so that directors and business owners are clear on whether their business is eligible, their rights and obligations under BDH, and that all of the procedural requirements are met.

Want to know more?

If you have any questions, please contact our specialist [Insolvency and Restructuring](#) Team.