Impact Summary: Extension of Business Debt Hibernation scheme

Section 1: General information

Purpose
The Ministry of Business, Innovation & Employment is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions by the Minister of Commerce and Consumer Affairs and the Minister of Finance (**joint Ministers**) to extend the Business Debt Hibernation scheme (**BDH**).

Key Limitations or Constraints on Analysis

BDH was put in place as an urgent, temporary measure during the March – May COVID lockdown to address the fact that many businesses were expected to face significant financial pressure as a result of the impacts of COVID-19. The decision to implement BDH was exempted from RIA analysis.

The decision addressed in this document is whether the joint Ministers should extend BDH according to the statutory criteria in the COVID-19 Response (Further Management Measures) Legislation Act 2020 (**FMM Act**), or whether to let BDH expire.

The constraints on the analysis in this document are that:

- The decision on whether or not to extend BDH is dictated by the criteria set out in the legislation.
- We do not have good information about:
  - the impact of BDH due to the small number of businesses who have used it
  - creditors not taking action because of the availability of BDH
  - the ongoing economic effect of COVID-19 on business; and
  - the extent that smaller businesses are considering BDH as an option to resolve their liquidity problems.
- We do not have a full understanding of why there has been an increase in voluntary removals from companies register or why there has been a reduction in liquidations.
- The information that we do have about the impact of COVID-19 on liquidations and company deregistration's has been gathered at a time where there is a complex range of policy interventions in place. This makes it difficult to isolate the impact of BDH from the impact of those other policies.
- It has not been practicably possible to gather the information that would fill these data gaps.

Responsible Manager (signature and date):
Susan Hall Manager, Corporate Governance and Intellectual Property Policy Commerce, Consumers and Communications Branch Building, Resources and Markets Group Ministry of Business, Innovation & Employment

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
Quality Assurance Assessment:
Reviewer Comments and Recommendations:

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

- *How is the situation expected to develop if no further action is taken, and why is this a problem? (This is the basis for comparing options against each other)*
- *Why does the current situation constitute "a problem", or why is it expected to do so if it continues?*
- *What is the underlying cause of the problem? Why does government need to act – why can't individuals or firms be expected to sort it out themselves under existing arrangements?*
- *Why does it need to be addressed now?*
- *How much confidence is there in the evidence and assumptions for the problem definition?*

Background and current situation

On 15 May 2020, Parliament passed the FMM Act, which provided regulatory relief for businesses and entities affected by COVID-19. The FMM Act amended the Companies Act 1993 to temporarily put in place the ability for business to enter BDH. The Treasury determined that the implementation of BDH was a direct Covid-19 response and, therefore, the RIA requirements did not apply to it.

BDH allows businesses affected by COVID-19 disruptions to place their existing debts on hold for up to 7 months (one month unilaterally and 6 months with the consent of their creditors), and provides a supporting statutory framework to allow them to have discussions with their creditors to establish whether there is a viable path for the business to survive when it leaves BDH. ***BDH was put in place to stop otherwise viable businesses being liquidated***

When the BDH scheme was introduced there were concerns that many businesses were facing significant financial pressure as a result of the impacts of COVID-19 (either directly or because of its impacts on the economy as a whole). The options facing those businesses were to try to keep trading as normal, or respond to the pressure placed on them by liquidating, entering voluntary administration or negotiating a compromise with their creditors (e.g. agreeing that a portion of their debt will be written off or agreeing extended payment terms).

The Government was concerned that these options were, in the case of potentially viable businesses with existing staff and supply chains, undesirable for the economy.

The BDH scheme is designed to help these businesses by providing them with the ability to stop their creditors taking formal legal action against them for non-payment of their debts. This gives businesses time, and a supporting statutory framework, to have discussions with their creditors to establish whether there is a viable path for the business to continue. While creditors are prevented from taking enforcement action, the business is able to work with their creditors to find a longer-term solution to their liquidity problems.

If it is not possible for a business to survive long term, its creditors are also able to agree that delaying liquidation (provided it is consistent with insolvency law more generally) is better than immediately moving to liquidation – which would have the effect of crystallising their losses.

Statutory purposes of BDH

The aim of BDH is reflected in its statutory purposes, which are to:

- provide for the business, property, and affairs of an entity that is facing significant liquidity problems, or an entity that may in the future face such problems, because of the effects of the outbreak of COVID-19 to operate in a way that:
    - maximises the chances of the entity, or as much as possible of its business, continuing in existence; or
    - if it is not possible for the entity or its business to continue in existence, results in a better return for the entity's creditors and members than would result from an immediate liquidation of the entity.
- to give businesses some temporary protections relating to their debts in order to give it an opportunity to develop, with its creditors, a longer-term approach to its liquidity problems.

The statute makes it clear that it is not a purpose of BDH to allow:

- a business, that has no realistic prospect of continuing to trade or operate in the medium or long term, to defer a decision to enter into liquidation to the detriment of its creditors
- the debts owing by a business to be cancelled
- the rights of creditors to be varied, in any significant way, after the end of the temporary period of protection.

Key features of BDH

The key features of BDH are that:

- 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:
    - the entity has, or in the next 6 months is likely to have, significant liquidity problems; and
    - the liquidity problems are, or will be, a result of the effects of COVID-19 on the entity, its debtors, or its creditors; and
    - it is more likely than not that the entity will be able to pay its due debts at a certain date.

  (the "threshold test")
- an entity in BDH benefits from a moratorium on the ability of creditors to take enforcement action against them
- after an initial one month period, an entity can remain in BDH only with the agreement of more than 50% (by number and value) of its creditors
- it is a temporary status designed to encourage entities and creditors to work together on a more enduring solution – an entity cannot be in BDH for more than a total of seven months.
- it is designed to be used by all sizes of entity, and is supported by guidance to make it as accessible as possible to SMEs
- there are procedural safeguards built into the BDH process designed to minimise the risk of the BDH process materially prejudicing creditors interests.

In the absence of BDH a creditor who had not been paid by a business would need to take legal action to require payment of any debts due to them or otherwise liquidate the company.

The primary problem

The ability for business to enter BDH is time bound – no entity can enter BDH after 24 December 2020 (unless that date is extended by regulation). The provision to extend BDH was included in the FMM Act because of the uncertainty on the ongoing impacts of COVID on the economy, and the acknowledged potential for further lockdowns to take place in New Zealand. Ministers must now decide whether they wish to extend the ability for businesses to enter into BDH beyond this date.

If the ability for businesses to use BDH falls away, businesses who are currently facing significant liquidity problems due to the impacts of COVID-19, or may face such problems if further lockdowns eventuate will not have access to the process. They will be required to decide between:

- trying to continue trading
- liquidating
- entering voluntary administration
- negotiating a compromise with their creditors (e.g. agreeing that a portion of their debt will be written off or agreeing extended payment terms),

without the benefit of a supporting statutory framework, to have discussions with their creditors to establish whether there is a viable path for them to continue.

This could result in:

- Fewer businesses, which were economically viable before the impacts of COVID-19, recovering. It is in the interests of the economy as a whole if as many viable businesses, with existing employees and supply chains, are able to continue trading.
- Creditors not being able to support a managed winding up of a business - ie continuing to operate a business while the sale of the business as a going concern as an alternative to formal insolvency is explored.

Constraints on problem definition

The analysis in this document is focused on whether or not BDH should be extended. This is because that is the immediate question that needs to be answered. Cabinet and Parliament have already decided to implement BDH and alternative forms of support are outside of the scope of the decision Ministers are now being asked to make.

Accordingly this analysis does not address broader questions such as what the nature of ongoing government support for business should be in light of the impacts of COVID-19 or whether there should be additional forms of government support in addition to, or instead of, BDH. Similarly, the analysis in this document does not address whether the BDH process should be modified.

Why it needs to be addressed now

The ability for business to enter BDH will cease on 24 December 2020. Ministers are able to extend this beyond this date by regulation.

If the ability of businesses to enter into BDH is not extended before this date then businesses will lose access to a possible restructuring tool.

Evidence and assumptions

BDH has been an effective tool for helping viable businesses survive

The following table summarises the number of businesses which have sought to use BDH in the period since 15 May 2020 to the week ending Sunday 4 October 2020:

Total number of entities who have applied to enter BDH	41 businesses
Percentage of entities whose creditors have agreed for them to enter the additional 6 month moratorium	38% (14 businesses)
Percentage of entities who have entered BDH and are awaiting approval decision of their creditors to enter an extended moratorium period	8% (3 businesses)
Percentage of businesses that were unable to obtain the approval of their creditors to enter into an extended moratorium period or did not seek that approval	54% (20 businesses)
Number of entities whose entry into BDH failed for other reasons	4 businesses

While the uptake of BDH has been low our data suggests that it has been effective in providing a framework for businesses to agree a moratorium with their creditors. Of the businesses which have applied to enter into BDH 38% were able to agree entry into an extended moratorium period with their creditors during which no one could take enforcement action against them. Conversely in 54% of cases creditors were unwilling to agree to businesses remaining in BDH and prevented such an arrangement being put in place. Some stakeholders have also suggested that the mere existence of BDH as an option for businesses has meant that it has not needed to be used i.e. creditors have been prepared to agree informal compromises with debtors where the alternative is BDH. We have not been able to obtain data on the extent to which this is happening.

Possible reasons for low uptake of BDH to date

It appears that the low number of businesses seeking to use BDH is in large part caused by the fact that many businesses do not need BDH protection because they have not been facing significant financial pressure from their creditors. More specifically:

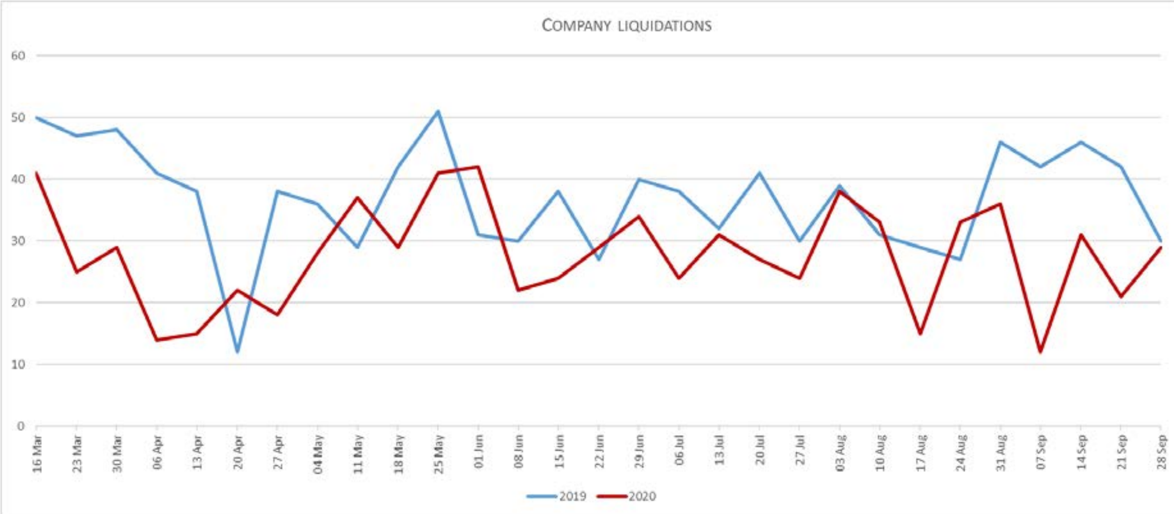
- Tax debt is the most significant driver of insolvency in New Zealand. This year the Inland Revenue Department has aligned itself with the Government's approach to economic recovery from the impact of COVID-19 and has given businesses that temporarily find themselves insolvent more time and assistance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

- Larger creditors, such as banks, do not currently wish to be seen to take the first step against smaller businesses for reputational reasons. Larger creditors are currently concerned that taking action against smaller creditors could be perceived as “predatory” or unduly aggressive. However feedback from stakeholders suggests that this forbearance will not last.

- Other interventions such as the Small Business Cashflow Loan Scheme and Wage Subsidy have had the effect of:
  - Providing many businesses with the necessary short term liquidity to meet their immediate obligations
  - Reducing the pressure on creditors which has increased their tolerance for late payment by their debtors.
- Practical difficulties with taking enforcement action through the High Court while the country was in lockdown.

These factors have contributed to an overall reduction in the number of company liquidations in 2020.

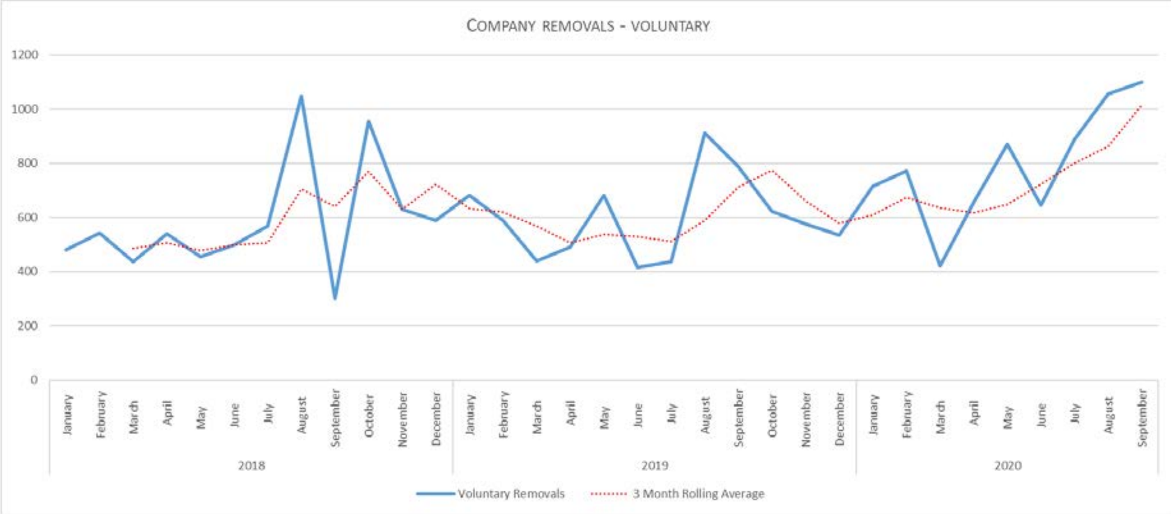
Figure 1: Company Liquidations



Taken by itself, and using companies as a proxy for businesses generally, this could suggest that the number of businesses which are vulnerable to being liquidated because of their level of indebtedness is building up within the economy. However, at the same time more businesses have been voluntarily removing themselves from the Companies Register (eg choosing to pay their creditors and then to wind themselves up). Post lockdown, company voluntary removals have trended upwards with year-to-date removals up 32% on 2019[1]. This may have offset the reduction in the number of company liquidations.

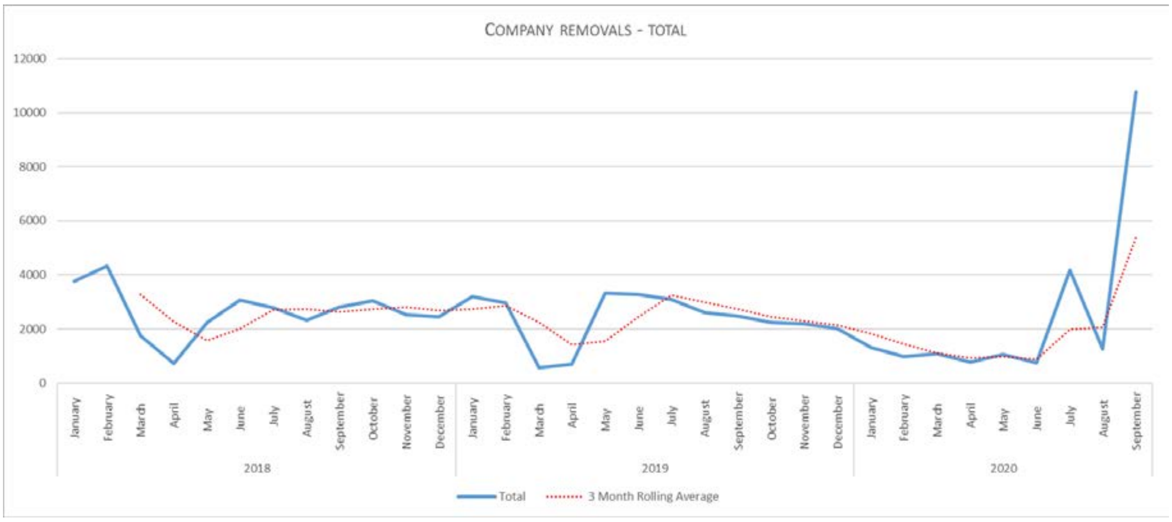
Figure 2: Voluntary company removals

[1] While the recent increase in removals could be influenced by MBIE recommencing its enforcement activities following the end of lock-down, we would not expect this to have influenced the overall trend in removals over the year.



We do not have a full understanding of why the increase in voluntary removals has occurred or why there has been a reduction in liquidations. One possible explanation is that businesses have not been facing significant financial pressure from their creditors which BDH could address. Rather they have been taking stock of their financial position and choosing to wind-up where they consider they have no realistic prospect of surviving.

Figure 3: Total company removals



We also do not have a full understanding of what this data implies about the number of businesses which are vulnerable to being liquidated because of their level of indebtedness within the economy. However, the overall increase in removals could imply that the number of such companies is not as high as might be indicated by the drop in liquidations.

Comparison with analogous insolvency processes

The most analogous insolvency proceeding to BDH is voluntary administration (though they are not perfect substitutes). In the period since it was implemented BDH has had a comparable success rate to voluntary administration (over the previous two years) – ie a similar proportion of businesses have been able to obtain the support of their creditors to trading on. At the same time more businesses have chosen to use BDH to resolve their liquidity issues – we expect that this is the result of the fact that BDH was designed to address the specific issues faced by businesses as a result of COVID-19. These two factors suggest that BDH is seen, by those businesses who have used it, as a more effective/appropriate tool to resolve the problems they are facing, as a result of the impact of COVID-19, than the existing suite of insolvency mechanisms in the Companies Act.

The other options open to entities are to:

- Enter into a formal compromise arrangement with their creditors – Under this option creditors representing a majority in number and 75% in value of debts can commit all creditors in a class of creditors to a compromise e.g. changes to the legal arrangements between the parties rescheduling debts or reducing levels of indebtedness.
- Enter into an informal compromise arrangement with their creditors – Under this option they would reach individual arrangements with certain individual creditors e.g. agreeing a rent reduction with their landlord.

We do not consider either of these options to be analogous to BDH as they do not involve the imposition of a formal moratorium on enforcement action being taken by creditors.

How voluntary administration works

In voluntary administration the directors of a company hand control of their business to a licensed insolvency practitioner. That practitioner makes an assessment of the financial affairs of the company and then presents their findings to the creditors of the company. Those creditors can then vote on entering into a deed of company arrangement – which sets out the terms on which the company will be allowed to continue trading. If the creditors do not agree to enter into a deed of company arrangement the company will be liquidated.

While the insolvency practitioner is preparing their report to creditors, creditors are prevented from taking enforcement action against the company in voluntary administration – similar to the moratorium a business has while it is in BDH.

There has been greater uptake of BDH than voluntary administration

In the period since BDH was introduced (May to September 2020) 15 businesses have entered voluntary administration. Over a similar period 41 businesses have chosen to enter BDH. This suggests that businesses are preferring to use BDH to resolve the solvency problems they are facing as a result of COVID-19 rather than voluntary administration. We expect that this is the result of the fact that BDH was designed to address the specific issues faced by businesses as a result of COVID-19.

BDH has a similar success rate to voluntary administration

38% of businesses who have sought to use BDH have been obtained the agreement of their creditors to remaining in BDH. This is a **comparable** success rate to voluntary administration. In the period since January 2018 86 businesses have entered voluntary administration. Of those, 53 subsequently went into liquidation (and therefore 33 did not), giving a “success” rate of 38.37%.

Applicability to future COVID related economic shocks

In the event that BDH is extended it will remain available for businesses which were solvent, as at 31 December 2019, who suffer solvency issues as a result of the effects of COVID-19 on the entity, its debtors, or its creditors.

This is intended to ensure that BDH would remain available to businesses in the event of additional shocks following the initial lockdown e.g. any further lockdowns put in place in response to the COVID-19 pandemic.

2.2 Who is affected and how?

- *Whose behaviour do we seek to change? How is it expected to change and to what purpose?*
- *Who wants this to happen? Who does not?*

Whose behaviour do we seek to change

We are seeking to change the behaviour of:

- **Debtors**: When the BDH scheme was introduced there were concerns that many businesses were facing significant financial pressure as a result of the impacts of COVID-19 (either directly or because of its impacts on the economy as a whole). Many of the businesses that kept going through lockdown did so in reliance on financial support from the Crown which is now ending. Some businesses continue to face significant liquidity problems due to the impacts of COVID-19, and more may do so if further lockdowns eventuate. Those directors may face a choice between:

    - trying to continue trading without that support
    - liquidating, or deregistering
    - entering voluntary administration, or
    - negotiating a compromise with their creditors.

    Continuing BDH in place will provide a tailored mechanism whereby, should = businesses face significant liquidity problems due to the impacts of COVID-19, the directors can talk to their creditors and understand their trading environment before making these decisions. BDH was initially introduced to the insolvency regulatory system to provide an accessible mechanism to business which, but for the effects of COVID-19, were otherwise viable. In the current circumstances, where in some cases the effects of COVID-19 are still present and where there is the potential for future lockdowns should widespread community transmission return to New Zealand, the continued availability of BDH will assist directors to work with their creditors to see if there is a way for the businesses to survive.

- **Creditors**: BDH provides a consent based mechanism for creditors to bind themselves to not take enforcement action against a company or other entity in the hope that it will be able to survive and repay its creditors. As noted above, it is to the advantage of the economy as a whole if as many viable businesses, with existing supply and employment arrangements in place, survive. BDH facilitates this by temporarily giving debtors and creditors a framework within which to try and find mutually beneficial solutions in the current, fluid economic environment.

Alternatively, if it is not possible for a business to survive long term, BDH can also serve as a mechanism for creditors to agree that delaying liquidation (provided it is consistent with insolvency law more generally) is better than immediately moving to liquidation – which would have the effect of crystallising their losses. Where a business is facing significant liquidity problems due to the impacts of COVID-19, the continued availability of BDH will encourage creditors to work with their debtors to see if there is a way for the business to survive.

Who does and does not want this to happen?

We consider that it is in the collective interests of debtors, creditors and the economy as a whole for BDH to be continued to maintain its ongoing assistance to businesses which are facing the ongoing effects of COVID-19, or which will face significant liquidity problems if further lockdowns eventuate.

Professional advisers (i.e. lawyers and insolvency practitioners), as well as the Institute of Directors support the extension of BDH.

Feedback from banks on extending BDH was mixed (see discussion in section 5).

2.3 What are the objectives sought in relation to the identified problem?

- *Objectives must be clear and not pre-justify a particular solution. Where there are multiple policy objectives, it should be clear how trade-offs between competing objectives are going to be made and the weightings given to objectives – not just those in direct conflict.*
- *For further guidance, the Guidance Note on Best Practice Analysis https://treasury.govt.nz/sites/default/files/2018-03/ia-bestprac-guidance-note.pdf*

Per section 395B of the Companies Act 1993, the statutory criteria against which any decision to extend the BDH scheme must be assessed are:

- the statutory purposes of the BDH scheme set out at section 2.1 above, and
- the effect of the regulations on
  - the creditors of entities that have significant liquidity problems, and
  - the integrity of corporate insolvency law.

In making a decision on whether to recommend extending BDH, we have also assessed the whether it has been effective in providing businesses with a framework to agree a moratorium with their creditors.

Section 3: Options identification

3.1 What options have been considered?

- *List the options and the decision criteria you used to assess them. Briefly describe their pros and cons.*

The options available to Ministers are to:

- **Option 1**: Allow the BDH scheme to expire on 24 December 2020 (the status quo).
- **Option 2:** Extend BDH for a short period eg until 31 March 2021.
- **Option 3:** Extend the scheme for the maximum practicable period (to 31 October 2021 – 7 months before the section is repealed)[2] (**MBIE's recommended option**).

While both allowing BDH to lapse then reinstating it at a later date, or limiting BDH to a particular location or industry type are theoretically options, we have discarded them for the purposes of this analysis for the following reasons:

- Allowing BDH to lapse and then reinstating it would create uncertainty for businesses about what options are available to them. This could undermine the attempts of businesses to use the regime to resolve their liquidity problems and would mean that BDH would not be immediately available to help businesses in the event of any further shocks.
- Limiting the availability of BDH to businesses in a particular location or industry type would introduce additional complexity into the regime and would risk creating arbitrary results. For example, if access to BDH were limited to businesses located in Auckland then businesses headquartered in other centres would be unable to use it notwithstanding that their client base might be located in Auckland and impacted by any conditions that justified that limitation.

3.2 Which of these options is the proposed approach?

- *Which is the best option? Why is it the best option?*
- *How will the proposed approach address the problem or opportunity identified?*

We consider that option 3 is the best option. Using the criteria outlined in section 2.3, we have reached this view on the following basis.

	Option 1	Option 2	Option 3
1.) Consistency with the statutory purpose of the BDH scheme	✘	✓	✓✓
2.) Effect on creditors of entities that have significant liquidity problems	✓	-	-

[2] If the ability of businesses to enter into BDH were extended beyond 31 October 2021then the relevant provisions would be repealed part way through the period in during which they were in BDH. This would create uncertainty as to the extent of any protections which the business had. For this reason we consider this to be the maximum practical period for extending the BDH regime

3.) The effect of the regulations on the integrity of corporate insolvency law.	✓	✓	✓
4.) Effective in providing businesses with a framework to agree a moratorium with creditors.	✗	✓	✓

Criterion #1: Consistency with the statutory purposes of the BDH scheme

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.*

The statute states that it is expressly not a purpose of BDH to allow:

- a business, that has no realistic prospect of continuing to trade or operate in the medium or long term, to defer a decision to enter into liquidation to the detriment of its creditors
- the debts owing by a business to be cancelled
- the rights of creditors to be varied, in any significant way, after the end of the temporary period of protection.

We consider that an extension of the BDH scheme to 31 October 2021 (Option 3) is most consistent with this purpose. While many businesses have faced, and continue to face, significant disruptions due to the impact of COVID-19, this has not translated into an increase in the number of businesses being liquidated. New Zealand's GDP fell by 12.2% in the June quarter. We would ordinarily expect such a contraction to be accompanied by a very large increase in the number of liquidations, however the number of liquidations in the same period was lower than in the previous year.

While it is difficult to identify the exact cause of this, we do not expect this to continue. All of the stakeholders we have consulted with expect the number of corporate insolvencies to increase in the coming year particularly due to the expiry of other forms of government support.

Extending the BDH scheme for the maximum period will ensure that, when creditors begin to put financial pressure on distressed businesses, those businesses have a statutory framework to use to work with their creditors to find solutions to their liquidity problems, provided the threshold test in the statute is met. If a long term solution cannot be agreed upon, BDH provides a short term solution (at least where creditors agree that is preferable to immediate liquidation).

The extension of the BDH will also ensure that BDH remains available to businesses which were solvent, as at 31 December 2019, in the event of any further shocks to the economy as a result of COVID-19. For example if any additional lockdowns are required to be put in place. We consider that making BDH available to businesses in such circumstances is consistent with the overall purpose which BDH was put in place to achieve.

Extending the BDH scheme will also increase the chances of viable businesses continuing in existence, which is better for both individual businesses, creditors and the wider economy.

	Option 1	Option 2	Option 3
Consistency with the statutory purpose of the BDH scheme	✘	✓	✓✓

Criterion #2: Effect on creditors of entities that have significant liquidity problems

When a business enters BDH, its creditors are prevented from taking enforcement action against it for non-payment of debt. This can place those creditors under financial pressure because they are then unable to pay their own creditors. For this reason allowing the BDH scheme to expire is the best option from the perspective of creditors – it is always open to them to decide not to take enforcement action which is what BDH compels them to do.

However, a business cannot enter into BDH unless the threshold test is met and remain in BDH for more than a month without the consent of a majority (both by number and value) of its creditors. This provides a significant constraint against the misuse of the regime. In 54% of cases creditors have successfully exercised their rights to prevent a business from remaining in BDH after the expiry of the initial one month period.

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. Any payment would also be delayed by the need to appoint a liquidator and complete the liquidation process. For this reason BDH will not necessarily materially delay payment to creditors and can act as a useful alternative to the liquidation process. BDH also avoids the risk that creditors will seek to beat each other to take enforcement action to recover outstanding amounts from distressed businesses (i.e. racing to recover the limited assets of the debtor business) – potentially resulting in the unnecessary liquidation of the business.

Nonetheless, there remains a theoretical risk that, even with the creditor approval processes, BDH could be misused or otherwise have detrimental economic effect on the creditors of businesses that enter BDH. This could happen where, for example:

- creditors feel they have no choice but to agree to the BDH process
- if the wishes of a substantial minority of creditors (to not enter into BDH) is ignored, or

- because the BDH process for a particular firm does not resolve the liquidity issues of that firm, and ultimately has a harmful effect on its creditors.

However, stakeholders have not raised any concerns with officials about the process for a business to enter into BDH being abused or concerns about the impacts of BDH on other businesses. To the contrary, some stakeholders have suggested that the procedural requirements, put in place to prevent abuse of the BDH scheme and protect creditor interests, are too strict and that is reducing uptake of the scheme[3]. We consider that these requirements strike an appropriate balance between supporting business rehabilitation and protecting creditor interests.

Taking the above factors into consideration, while we do not consider that there is any evidence to suggest that extending the BDH scheme will have a detrimental effect on the creditors of businesses that might use it.

In addition if further lockdowns are required to be put in place BDH has the potential to serve as a framework to allow impacted businesses to have discussions with their creditors to establish whether there is a viable path for the business to survive. This is preferable to otherwise viable businesses being liquidated.

	Option 1	Option 2	Option 3
Effect on creditors of entities that have significant liquidity problems	✓	-	-

Statutory criterion #3: The effect of the regulations on the integrity of corporate insolvency law

Corporate insolvency law 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 and disruption to supply chains. Early liquidation minimises losses to creditors.

BDH is a temporary measure that seeks to reflect this balance in the current circumstances, in particular during lockdowns by providing temporary relief to businesses facing financial pressure as a result of the impacts of COVID-19. Before the introduction of BDH, the options open to businesses facing significant liquidity problems were to:

- attempt to trade through their liquidity problems
- liquidate or deregister
- enter voluntary administration, or
- negotiate a formal compromise with their creditors.

There was no option for businesses which gave them the benefit of a moratorium against enforcement and:

- allowed them to retain control of their business while the process was

[3] We note that reducing these procedural requirements is out of scope of the analysis in this document.

completed

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

By providing such an option, BDH fills a gap within New Zealand's insolvency law framework – effectively allowing businesses time to work through their options and determine whether any of the other options for continuing might work. I.e. determine where the business can be rehabilitated in order to preserve its value or whether it should be wound up to minimise losses to creditors. Allowing these decisions to be reached based on a negotiated basis rather than because a single creditor took precipitous enforcement action.

We have not heard any feedback from stakeholders to the effect that the ability for businesses to enter into BDH is undermining the integrity of corporate insolvency law nor have any concerns been raised by stakeholders that the existence of BDH is undermining corporate insolvency law.

	Option 1	Option 2	Option 3
The effect of the regulations on the integrity of corporate insolvency law.	✓	✓	✓

Criterion #4: Effective in providing businesses with a framework to agree a moratorium with creditors.

While the uptake of BDH has been low, and therefore we have a limited sample size from which to draw conclusions, our data suggests that BDH has been effective in providing a framework for businesses to agree a moratorium with their creditors. Of the businesses which have successfully entered into BDH 38% were able to agree entry into an extended moratorium period with their creditors during which no one could take enforcement action against them.

The most analogous insolvency proceeding to BDH is voluntary administration. While BDH has a comparable success rate to voluntary administration (see data above), because more businesses appear to be using BDH relative to voluntary administration, it would appear to overall be a more effective mechanism in achieving the business rehabilitation objective of the insolvency system at this time.

We note that we do not have any evidence to prove that those creditors would have taken enforcement action in the absence of BDH or that BDH was necessary to bring debtors and creditors together to agree a solution. However, if business did not think it was useful we not expect them to use it.

	Option 1	Option 2	Option 3
Effective in providing businesses with a framework to agree a moratorium with creditors.	✗	✓	✓

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits
Summarise the expected costs and the benefits in the form below. Add more rows if necessary. *Give monetised values where possible. Note that only the **marginal** costs and benefits of the option should be counted, ie, costs or benefits additional to what would happen if no actions were taken. Note that "wider government" may include local government as well as other agencies and non-departmental Crown entities.* *See http://www.treasury.govt.nz/publications/guidance/planning/costbenefitanalysis for further guidance*

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Regulated parties	Inability to take enforcement action for non-payment of debt – potentially resulting in consequential financial difficulties	Low – as BDH cannot significantly delay enforcement action without creditor consent.
Regulators	Cost of continuing registry changes made to support BDH	Low – the costs of updating the corporate registries system to display information about BDH has already been incurred, ongoing costs associated with continuing the regime are expected to be low
Wider government	Inability to take enforcement action for non-payment of debt	Low - BDH cannot significantly delay enforcement action without creditor consent (including the Crown).
Other parties		
Total Monetised Cost		
Non-monetised costs		*Low*

Expected benefits of proposed approach, compared to taking no action		
Regulated parties	Benefit of additional time to make assessments as to whether to continue trading	Low – While BDH has shown itself to be of use for those businesses

		which have used it, because its overall uptake has been low the overall impact is expected to be low
Regulators		
Wider government		
Other parties		
Total Monetised Benefit		
Non-monetised benefits		*Low*

4.2 What other impacts is this approach likely to have?
• *Who has been, or will be consulted, and at what stage(s)? Has consultation with iwi/hapū occurred, or should it?*
Continuing the ability for businesses to use BDH is expected to increase the likelihood that businesses which have been negatively impacted by COVID will be able to work with their creditors to find a way for them to continue trading. It is to the benefit of the economy as a whole for as many, otherwise viable, businesses to survive – retaining their employees and supply chains.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

- *Who has been, or will be consulted, and at what stage(s)? Has consultation with iwi/hapū occurred, or should it?*
- *What is the nature of their interest?*
- *Do they agree with your analysis of the problem and its causes?*
- *Do they agree with your proposed approach?*
- *Has your proposed approach been modified as a result of stakeholder feedback?*

MBIE has consulted with the Treasury, the Reserve Bank of New Zealand and the Inland Revenue Department. All agencies have expressed support for extending BDH for the maximum practicable period (option 3).

Targeted consultation was also undertaken with:

- the Institute of Directors
- the Restructuring, Insolvency and Turnaround Association of New Zealand (**RITANZ**)
- the New Zealand Bankers' Association (**NZBA**)
- practitioners in two large law firms that specialise in corporate and insolvency law.

These stakeholders were generally in favour of extending BDH. The Institute of Directors, RITANZ and both of the law firms consulted supported extending BDH on the basis that while it has not been taken up by many businesses to date it could prove to be a useful tool in the coming months.

The feedback from banks, received via the NZBA, was mixed. Two of the six banks who provided feedback supported extending BDH. The concerns of the other banks focussed on the following points:

- The limited uptake of BDH indicates it has not been effective. We do not find this argument persuasive.
- Other forms of Government support, such as the wage subsidy, are better suited to assist businesses impact by COVID-19. We do not consider that this

is a relevant factor when deciding whether or not to extend BDH.

- Other restructuring tools already exist within the law and BDH is not needed to address the liquidity problems face by businesses. In this regard we note that data suggests that BDH provides a useful alternative to the most analogous alternative restructuring tool (voluntary administration).

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
• *How will the proposed approach be given effect? eg,* • *legislative vehicle* • *communications* • *transitional arrangements* • *Once implemented, who will be responsible for ongoing operation and enforcement of the new arrangements? Have they expressed any concern about their ability to do so?* • *When will the new arrangements come into effect? Does this allow sufficient preparation time for regulated parties?* • *How will implementation risks be managed or mitigated?*
Any decision to extend BDH will be given effect to by way of regulations made under section 395B of the Companies Act. As the BDH scheme is already in effect there is no need to allow a transition period for it to begin. There is a risk that, even with the creditor approval processes, the BDH could be misused or otherwise have detrimental economic effect on creditors of businesses. This could happen, for example: • where creditors feel they have no choice but to agree to the BDH process • if the wishes of a substantial minority of creditors (to not enter into BDH) is overridden, or • because the BDH process for a particular firm does not resolve the liquidity issues of that firm, and ultimately has a harmful effect on its creditors. Should any evidence arise suggesting that the BDH regime is being misused it will be possible to address those concerns by regulation. Those regulations could have the effect of: • limiting the scope of the regime (for example to limit the types of entities which are able to enter BDH) • excluding certain types of debt from the regime • prescribing transitional, savings or related provisions, or • setting or adjusting a range of technical and procedural requirements. We would expect to be made aware of concerns about the misuse of the BDH regime via: • complaints made to the Companies Office – which administers the registers on which a business's entry into BDH is notified • trusted stakeholders within the corporate insolvency system e.g. insolvency practitioners.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
• *How will you know whether the impacts anticipated actually materialise?* • *System-level monitoring and evaluation* – *Are there already monitoring and evaluation provisions in place for the system as a whole (ie, the broader legislation within which this arrangement sits)? If so, what are they?* – *Are data on system-level impacts already being collected?* – *Are data on implementation and operational issues, including enforcement already being collected?* • *New data collection* – *Will you need to collect extra data that is not already being collected? If so, please specify*
The Corporate Registries system was changed as part of the initial implementation of BDH to collect data on the uptake and use of BDH. This information is included within regular monitoring reports prepared to monitor the overall health of the corporate registry and insolvency systems. There are however limitations on the ability to isolate the impact of BDH on the economy as a whole from other policy interventions such as the Small Business Cashflow Loan Scheme and Wage Subsidy as well as from other factors which are impacting on the decision making of debtors and creditors.

7.2 When and how will the new arrangements be reviewed?
• *How will the arrangements be reviewed? How often will this happen and by whom will it be done? If there are no plans for review, state so and explain why.* • *What sort of results (that may become apparent from the monitoring or feedback) might prompt an earlier review of this legislation?* • *What opportunities will stakeholders have to raise concerns?*
We consider that it would be appropriate to undertake an internal review of the effectiveness of the BDH regime after its expiry to determine whether there is a case for making it, or a similar mechanism, an enduring part of the insolvency system.