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LAWYERS

A legal guide to navigating COVID-19 and its effects

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Disclaimer

This guide has been produced for the purpose of providing general information and should not be construed or acted on as legal advice. There are several legal and other considerations that are not mentioned, or not explained fully, in this guide. Specific advice should be sought to ensure that the information contained in this guide applies correctly to your situation and has not been subsequently altered by developments in law or otherwise.

The situation with COVID-19 is continually evolving. We have no obligation to notify you if changes to law or otherwise occur which affect the content of this guide.

Updated 9 April 2020

Part 1: Background

COVID-19 (novel coronavirus) was first reported in Wuhan City, Hubei Province, China on 31 December 2019 and has now spread to many other countries. The World Health Organisation declared the outbreak a pandemic on 11 March 2020.

The New Zealand Government introduced a four-tier alert system and escalated the alert level to 3 on 23 March 2020. 24 hours later, at 11.59 pm on 25 March, the alert level was escalated to level 4.

While this guide is not a substitute for legal advice, we hope that this guide will help the New Zealand business community navigate the legal issues that have arisen from COVID-19. Circumstances like this give rise to many different legal issues – only a selection of those are discussed in this guide, based on our recent experience within the areas of law that we practice.

Part 2: Contracts

1. Introduction

The impact of the outbreak on supply chains, international travel, markets and regulation has made it more difficult or impossible for some businesses to fulfil contractual obligations. This part considers the concepts of force majeure, material adverse change, frustration and termination in the context of contracts generally.

2. Force majeure

A force majeure clause typically excuses a party (**affected party**) from a contractual obligation if:

- a specified event occurs (e.g. an act of God, natural disaster, war or act of government). COVID-19 may fall within the category of an 'act of God'. 'Acts of government' may also be relevant if restrictions imposed by a government in the fight against COVID-19 prevent fulfilment of a contractual obligation; and

- that event:

  - prevents the affected party from fulfilling a contractual obligation; and

  - is outside of the control of the affected party (and the affected party took reasonable steps to avoid, or mitigate the effects of, the event).

There is no general doctrine of force majeure in New Zealand. Force majeure only applies if the contract contains a force majeure clause and, if it does, the application of the force majeure clause depends entirely on its wording. Some force majeure clauses entitle termination of the contract if the event continues for a specified period of time.

3. Material adverse change

A material adverse change clause typically allows a party to terminate the contract if a material adverse change occurs to the other party or the subject of the contract. Material adverse change clauses are often used by banks in their finance offers and loan documents.

Like force majeure, there is no general doctrine for material adverse change in New Zealand and so it only applies if a specific clause has been included in the contract. If the contract does contain a material adverse change clause, the particular wording of the clause must be considered in the context of the circumstances of the parties to that contract (and the effect COVID-19 has had on the parties) to determine whether it applies and, if so, how.

4. Frustration

The doctrine of frustration should also be considered, particularly if there is no force majeure or other clause that provides relief in the circumstances. A contract is frustrated where, by no fault of either party, an intervening event makes performance impossible or radically different to what the parties had agreed. The effect of a contract being frustrated is that it is automatically terminated[1].

A contract is not easily frustrated. While there is no doubt that COVID-19 has made performance of many contracts more difficult, delayed and/or more expensive, due to the high thresholds of 'impossible' or 'radically different', we expect that the frustration of contracts will be less common.

5. Termination

If a party (**defaulting party**) does not fulfil its obligations under a contract, the other party (**innocent party**) may wish to terminate the contract. The terms of the contract may entitle the innocent party to terminate in specified circumstances. Often this involves the innocent party giving written notice of the default to the defaulting party and, in some cases, allowing the defaulting party a period of time to remedy the default.

If the terms of the contract do not provide for termination, there may be other grounds for termination. For example, subpart 3 of part 2 of the Contract and Commercial Law Act 2017 entitles a party to terminate if:

- the other party makes it clear that it does not intend to perform its obligations under the contract[2] (this is known as 'repudiation');

[1] The consequences of frustration are detailed in subpart 4 of part 2 of the Contract and Commercial Law Act 2017

[2] Section 36 of the Contract and Commercial Law Act 2017

- the innocent party was induced to enter into the contract by a misrepresentation of an essential term[3]; or

- an essential term of the contract is breached (or it is clear that an essential term will be breached)[4].

Before exercising any right of termination, the innocent party should consider whether there is any force majeure or other clause which provides relief to the defaulting party in the circumstances.

6. Recommended steps

Existing contracts

We recommend that existing contracts which have been (or could be) impacted by COVID-19 are reviewed promptly. In some cases, a party must give notice within a specified time period to preserve that party's right to rely on a force majeure, termination or other clause.

Parties should be cautious about claiming relief on the basis of force majeure, material adverse change or frustration or otherwise purporting to terminate a contract. If a claim is made without grounds, or without following the required procedure, the claim could amount to an anticipatory breach or repudiation of the contract entitling the other party to terminate (and claim damages).

New contracts

For new contracts, we recommend that careful thought is given to how COVID-19 will (or could) impact the obligations of the parties, bearing in mind that the duration of the lock down, and wider restrictions, remains unknown to some extent (both in New Zealand and overseas). A clause may need to be included or amended to deal adequately with the impact that COVID-19 may have on the ability of the parties to fulfil their contractual obligations.

It may also be helpful to incorporate provisions which deal with practical issues such as early communication, alternative ways of working and project control groups (which meet via electronic means).

Part 3: Commercial leases

1. Introduction

The escalation to alert level 4 forced educational facilities and 'non-essential' businesses to shut their doors. This part considers the effect of COVID-19 on commercial leases, with specific reference to the Auckland District Law Society form of deed of lease (**ADLS Lease**).

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[3] Section 37(1)(a) of the Contract and Commercial Law Act 2017

[4] Section 37(1)(b) and (c) of the Contract and Commercial Law Act 2017

2. No access in emergency

Clause 27.5[5] was inserted into the ADLS Lease in 2012 (after the Christchurch earthquakes), and states:

> *"If there is an emergency and the Tenant is unable to gain access to the premises to fully conduct the Tenant's business from the premises because of reasons of safety of the public or property or the need to prevent reduce or overcome any hazard, harm or loss that may be associated with the emergency including[6]:*
>
> *(a) a prohibited or restricted access cordon applying to the premises; or*
>
> *(b) prohibition on the use of the premises pending the completion of structural engineering or other reports and appropriate certifications required by any competent authority that the premises are fit for use; or*
>
> *(c) restriction on occupation of the premises by any competent authority,*
>
> *then a fair proportion of the rent and outgoings shall cease to be payable for the period commencing on the date when the Tenant became unable to gain access to the premises to fully conduct the Tenant's business from the premises until the inability ceases."*

In summary, for clause 27.5 to apply there are three elements that must be satisfied:

- there must be an emergency;
- the tenant must be unable to gain access to the premises to fully conduct the tenant's business from the premises; and
- that inability must be because of reasons of safety of the public or property or the need to prevent, reduce or overcome any hazard, harm or loss.

We consider each of those elements below.

Element 1: Is COVID-19 an emergency?

The term 'emergency' is defined in clause 47.1(d), as follows:

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[5] Clause references are from the ADLS Lease (Sixth Edition 2012(5))

[6] A reference to the word "including" is to be interpreted without limitation (refer to clause 47(r))

"emergency for the purposes of subclause 27.5 means a situation that:

(1) is a result of any event, whether natural or otherwise, including an explosion, earthquake, eruption, tsunami, land movement, flood, storm, tornado, cyclone, serious fire, leakage or spillage of any dangerous gas or substance, infestation, plague, epidemic, failure of or disruption to an emergency service; and

(2) causes or may cause loss of life or serious injury, illness or in any way seriously endangers the safety of the public or property; and

(3) the event is not caused by any act or omission of the Landlord or Tenant"

Our view is that COVID-19 meets this definition of 'emergency' given that it:

- is an epidemic[7];
- has caused loss of life and serious injury; and
- was not caused by any landlord or tenant.

Element 2: Is the tenant unable to gain access to the premises to fully conduct the tenant's business from the premises?

The measures which apply for alert level 4 are:

- people instructed to stay at home;
- educational facilities closed;
- businesses closed except for essential services (e.g. supermarkets, pharmacies, clinics) and lifeline utilities;
- rationing of supplies and requisitioning of facilities;
- travel severely limited; and
- major reprioritisation of healthcare services.

While a premises may still physically be able to be accessed, in the case of educational facilities and non-essential businesses, the tenant is required by the Government to close. We think the example in 27.5(c) of a "restriction on occupation of the premises by any competent authority" anticipates a scenario where the premises is physically accessible but prohibited by Government or another authority.

[7] In any case, the list of 'events' in clause 47.1(d)(1) is not exhaustive (refer to clause 47(r))

This element is unlikely to be satisfied where the tenant is an 'essential business'.

Element 3: Is that inability because of reasons of safety of the public or property or the need to prevent, reduce or overcome any hazard, harm or loss?

The Government has clearly escalated New Zealand to alert level 4 for reasons of safety of the public (and to prevent, reduce and overcome harm).

3. What is a fair proportion?

If clause 27.5 does apply, a fair proportion of the rent and outgoings shall cease to be payable by the tenant until the tenant is able to regain access to the premises to fully conduct the tenant's business from the premises. The ADLS Lease does not specify how the 'fair proportion' is to be calculated. We think it is likely to depend on the particular situation taking into account factors such as:

- that COVID-19 is outside of the control of, and not caused by, the landlord or tenant;
- the extent that the tenant is continuing to use the premises (e.g. to store its possessions or advertise its business); and
- that the landlord is unable to use or re-lease the premises in the meantime.

Ideally, the landlord and tenant will agree what constitutes a fair proportion. If an agreement cannot be reached, the dispute resolution process in clauses 43.1 to 43.4 of the ADLS Lease will apply. If the dispute is unable to be resolved by mediation or other agreement within 30 days of the dispute arising, the dispute will be determined by arbitration.

4. Documenting the arrangement

Landlords and tenants should also consider how the arrangement will be documented and its finer terms, such as those explained below.

- If the arrangement is simply a temporary rent reduction (e.g. one month), a side letter signed by the parties should suffice. A deed of variation or supplementary agreement should be used if the arrangement is for a longer period of time or involves a fundamental or more complex change to the terms of the lease.
- Check that the person who is signing the document has authority to bind the landlord or tenant (as applicable). It is best practice for any guarantor to also sign.
- If there is an upcoming rent review, consider how that rent review will be affected by the arrangement. For example, the rent review could be discarded, proceed as normal or proceed on altered terms.

- Particularly if the landlord has multiple tenants, the landlord may wish to require that the tenant keep the arrangement confidential[8].

- Consider whether the arrangement should be personal to the landlord and tenant or will continue to apply if the landlord sells the premises and/or the tenant assigns the lease.

5. Termination

Clause 27.6 states:

> *"This subclause 27.6 applies where subclause 27.5 applies and the premises or building of which the premises form part are not totally or partially destroyed or damaged resulting in the lease being cancelled as provided for in subclauses 26.1 or 27.4. Either party may terminate this lease by giving 10 working days written notice to the other if:*
>
> *(a) the Tenant is unable to gain access to the premises for the period specified in the First Schedule; or*
>
> *(b) the party that terminates this lease can at any time prior to termination establish with reasonable certainty that the Tenant is unable to gain access to the premises for that period.*
>
> *Any termination shall be without prejudice to the rights of either party against the other."*

Government has advised that alert level 4 will last for at least four weeks, although it may continue for longer than that. At this stage, it seems unlikely that a lease will be able to be terminated on the basis of clause 27.6(b), unless the no access period has been shortened to 4 weeks (the default no access period is 9 months[9]). This may change as the likely duration of alert level 4 becomes foreseeable.

6. Other forms of lease

Where the lease is based on a pre-2012 version of the ADLS Lease (or another form of lease which does not contain a clause similar to clause 27.5), particularly in more extreme cases, it may be worth considering an argument that the lease has been frustrated on the basis that the restrictions imposed by alert level 4 make performance of the lease impossible or radically different to what the parties had agreed. The effect of a contract being frustrated is that it is automatically terminated.

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[8] The ADLS Lease does not contain a confidentiality clause.

[9] Clause 15(1) in the First Schedule

Due to the high thresholds of 'impossible' or 'radically different' a contract is not easily frustrated and the consequences of a lease being frustrated (i.e. termination) may not be in the interests of the landlord or tenant.

7. A commercial approach

We think the best outcome will be achieved through early communication and give and take on both sides. In most cases, it will be in the landlord's interests to assist the tenant so that it can resume trading after the alert level drops. Similarly, the tenant will need a premises to operate from going forward.

Part 4: Employment

1. Introduction

The COVID-19 situation has rapidly changed many workplaces and employment arrangements, the consequences which will be felt for months to come and will continue to evolve as New Zealand moves through the COVID-19 alert levels. Employers and employees need to be aware of their obligations and rights during this changing time; employment arrangements need to continue to be handled in good faith and with open and honest communication, which cannot be overlooked notwithstanding the difficulties in communication and uncertainties as to the months ahead.

2. Paying employees during COVID-19

Wage Subsidy Scheme

The Government has announced a wage subsidy scheme to support employers who have been adversely affected by COVID-19. The scheme is available for employers, contractors, sole traders and self-employed. The scheme is to assist in employers paying wages to employees – it does not change any other employment arrangements with the employee (whether under their employment agreement or employment law).

Where an employee is able to work from home or is working as an essential worker, then they should be paid as normal at their usual pay rate.

The wage subsidy is paid at $585.50 per employee working 20 or more hours per week and $350 per employee working less than 20 hours per week. The subsidy covers 12 weeks per employee and is paid as a lump sum to employers.

In order to qualify for the scheme, the following criteria must be met:

- the business must be registered and operating in New Zealand;
- the employees must be legally working in New Zealand;

- the business must have experienced a minimum 30% decline in revenue (actual or predicted) related to COVID-19 over a month compared to the same month in 2019;
- the business must have taken active steps to mitigate the impact of COVID-19; and
- the business must retain the employees covered by the scheme in employment for the period of the subsidy.

Employers should be making best endeavours to pay employees at least 80% of their normal income (pre-COVID-19). Where this is not possible, the full wage subsidy should still be passed on to employees (or their usual wage, if this is less than the subsidy amount).

Employers cannot unlawfully require or compel employees to use any other leave entitlements for any period during which employers are receiving the wage subsidy.

The subsidy can only be used to meet obligations in relation to paying employee wages – it cannot be used for other costs suffered by the business as a result of COVID-19.

The wage subsidy is considered 'excluded income' for income tax purposes for most businesses, however employers will need to make the usual deductions for PAYE, KiwiSaver, child support, student loan repayments and so on before paying on the wage subsidy to employees.

Essential workers leave

Essential businesses are able to continue operating throughout the alert level 4 lockdown, and employees of essential businesses are able to continue working (with health and safety obligations and appropriate processes followed in the workplace). However, not all employees of essential business will necessarily be willing or able to work during alert level 4 (or lower).

The Government has announced a new leave scheme, allowing essential workers who need to take leave in order to comply with the Ministry of Health COVID-19 guidance to be paid at the same rate as employees under the wage subsidy scheme ($585.50 per week for employees working 20 hours or more, $350 per week for employees working less than 20 hours). If employees are on other forms of paid leave, they should be paid at their usual level of pay.

Employers will be eligible to apply if they have experienced a 30% loss of revenue, or their ability to support essential workers needing to take leave has been negatively impacted by the COVID-19 public health restrictions.

The scheme is intended to support employees of essential businesses who:

- are self-isolating in accordance with Ministry of Health guidelines because they have contracted COVID-19, have come into contact with someone who has contracted COVID-19, or have a dependent they need to care for who is sick or self-isolating;

- are deemed at higher risk if they contract COVID-19, in accordance with Ministry of Health guidelines and are advised to self-isolate for the duration of the lockdown (or longer);

- have household members who are deemed at higher risk if they contract COVID-19, in accordance with Ministry of Health guidelines, and therefore the employees need to self-isolate for the duration of the lockdown (or longer) to reduce the risk of transmission to that household member and this is agreed with their employer.

The scheme is expected to be available whilst the country remains on alert level 4 and is anticipated for review in eight weeks' time. Payments will be made four-weekly, and employers can re-apply for the same employers after the initial four weeks whilst the scheme remains open.

Employees should be paid either:

- their usual weekly income (if less than the government leave allowance); or

- the full government leave allowance, with employers making best endeavours to pay employees at least 80% of their normal income.

Sick leave

If an employee, or a dependent for whom the employee cares, is sick (whether with COVID-19 or any other illness), the employee is entitled to use their sick leave entitlement, in accordance with the Holidays Act and their employment agreement.

Employees can only be paid sick leave when they are sick. An employer cannot pay sick leave to an employee who they have required not to come to work due to the employer's business being closed.

Once an employee's sick leave entitlements are exhausted, the employer and employee have the option of agreeing that the employee be paid any accrued annual leave to ensure continuity of income.

Annual leave

Employees may wish to take this opportunity to be paid any accrued annual leave; alternatively, employers may wish to require staff to take annual leave where there will be no work available for employees (such as during alert level 4 shutdown or at lower levels).

An employer cannot unreasonably refuse an employee's request for annual holidays – for example, some employees may now be in the position where they are the primary carer for dependents (small children or elderly family members) and cannot manage care with work commitments.

Employees and employers must reach agreement as to when annual leave can be taken; if no agreement is reached, an employer can require an employee to take annual leave by giving 14

days' notice, however the employer must have attempted to reach agreement first before taking this step. Employees cannot be forced to take annual leave that has not been accrued (i.e. in advance), nor can they be required to take annual leave with less than 14 days' notice.

Public holidays

If an employee is required to work on a public holiday, they are entitled to be paid for that day's work at time and a half of their usual pay; if the public holiday falls on a day that is the employee's regular day of work, the employee will also receive an alternative day off to be taken at a later date. This is in addition to any other benefits in the employment agreement for working on a public holiday.

If the employee is not required to work on the public holiday but the public holiday (or Mondayisation of the public holiday) falls on the employee's regular day of work, the employee is entitled to be paid as if they had worked the public holiday as a normal day's work.

Traditionally, Good Friday and Easter Sunday are non-trading days, and very limited businesses are allowed to remain open. There has been a relaxation of trading laws on Easter Sunday 2020, and supermarkets will be allowed to open (with some restrictions on items that can be sold). Employees can refuse to work on Easter Sunday without providing their employer with a reason and cannot be coerced to work. As Easter Sunday is not a public holiday, employees will not be paid time and a half, although employers can offer higher pay or other benefits as an incentive for staff to work.

3. Changing employment terms

Change of place of work

Just because a workplace is required to close, it does not necessarily mean that the employee is not able to continue working, albeit remotely. An employee should consider whether they are able to work from home safely and consider any employer request to work from home in good faith. There may be circumstances in which an employee cannot work safely from home, whether for their own health and safety or for the health and safety of others in the employee's home during the lockdown period.

An employee's home will become a *workplace* for the purposes of the Health and Safety at Work Act 2015; the employer will remain a *PCBU* or *person conducting a business or undertaking* whilst the employee is working from home, and will retain health and safety obligations for the employee including to provide them with a safe place of work. Employers and employees should remain in regular communication with each other regarding work from home arrangements to ensure that the employee's health and safety is not being compromised.

Change of hours of work

Every employment agreement is required to contain the employee's agreed hours of work (the number of hours, start and finish times, or days the employee will be required to work).

COVID-19 will affect every business, and will likely result in a reduction in workflow, if not immediately then in the months to follow lockdown. Alternatively, an employee may not be able to complete their full range of duties whilst working remotely. This may mean that it becomes uneconomic for an employer to continue employing employees at their usual hours of work. In addition, employees may struggle to cope with the demands of caring for children or other family members whilst working from home if schools and childcare remain closed, and should consider whether they will be ready, willing and able to work for the agreed hours of work each week.

Alternatively, some businesses may need employees to work additional hours to cope with additional work due to COVID-19 or to cover for employees who are unable to work during lockdown.

Some employment agreements will give the employer the ability to change the employee's hours of work unilaterally; where the employer has this right, they must act fairly and reasonably before they do so.

For any other change to an employee's hours of work, an employer will need to consult with the employee and reach agreement before implementing a change in hours. It may be that agreement to a reduction in hours cannot be reached, in which case each party may need to look at other options through restructuring or redundancy. An employer should be open and honest with the employee and give them a fair opportunity to consider the reduction in hours and to respond with any alternate proposals (which the employer must reasonably consider).

Change of pay

Every employment agreement should contain the employee's wages or salary (their pay). An employer cannot unilaterally change the employee's pay. Where the employer's business has been affected to an extent that the employer cannot afford to pay the employee their pay, the employer may need to look at options to reduce their costs, including employee pay. An employer must discuss any reductions in pay in good faith with affected employees prior to making any decisions, and endeavour to reach agreement where possible.

Any employee working during the lockdown period must be paid at least minimum wage for the hours that they work. Employers are encouraged to make use of the government's wage subsidy scheme where possible.

It is worth noting that the adult minimum wage increased on 1 April 2020 from $17.70 to $18.90 per hour, and the starting-out and training minimum wage increased on 1 April 2020 from $14.16 to $15.12 per hour.

If an employer cannot access payroll systems to have an employee's pay updated, this should be communicated clearly with employees and the pay increase should be processed as soon as the employer is able to do so.

4. Restructuring and other workplace changes

Workplace changes include restructuring (meaning that employees' jobs change), but could also extend to redundancies (meaning that employees' jobs end). Changes that may be made include the merger of positions, change of responsibilities, and redundancies, amongst other changes.

Any employer thinking of changing any employment arrangement should first review the relevant employment agreements and workplace policies. Employers are required to deal with all employees in good faith, and it is important that consideration is still given to this notwithstanding the COVID-19 situation. Without complying with their legal obligations and following a proper process, an employer could face a claim of unjustifiable dismissal.

There are two key considerations in any workplace change:

- A genuine business reason; and
- A fair process.

Genuine business reason

An employer must have a genuine business reason to make changes to their business and any previously agreed arrangements with employees. A workplace change cannot be used to manage performance issues of an employee, and an employee must not feel that they are unfairly targeted (to avoid the risk of a personal grievance being raised later).

An employer must show that any changes to an employee's position are for genuine business reasons – this includes providing the employee with the relevant information (which includes financial information) showing the need for a change to be made. This will include disclosing to employees the effects that COVID-19 has had, and is forecast as having, on the business.

Fair process

Employers are not permitted to make pre-determined decisions; they are required to complete a fair process of consultation with affected employees and take the employees' feedback into account.

The consultation should be a staged process, involving an initial discussion with employees as to the need for the change, the proposed change, and the provision of information, and a follow up after employees have had the opportunity to consider the information and suggest any alternatives to the employer's proposal. The employer must then reasonably consider the employees' proposed alternatives before advising the employee of the outcome.

Particularly in relation to redundancy or a reduction in pay, employers should first apply for the government's COVID-19 wage subsidy scheme where possible with the aim of keeping employees employed where possible.

5. Interrupting events

Workplace closures

Where a workplace is required to close (for example, where it is not an essential business able to operate during alert level 4 lockdown), but an employee remains ready, willing and able to work (i.e. is not sick nor required to care for any sick dependents), the employer is in general obliged to provide the employee with work and must pay them accordingly.

Conversely, where an employee is compulsorily quarantined (due to recent overseas travel or contact with a known COVID-19 case), then it is arguable that the employee is not ready, willing and able to work, and the employer may not be required to pay the employee (unless the employee is able to work remotely).

Force majeure

Depending on its wording, a force majeure clause (or other type of business interruption clause) may excuse a party from carrying out its obligations under an employment agreement (for example, of an employer being required to provide employment). Few employment agreements contain force majeure clauses, and in each case the clause will need to be reviewed to ascertain whether COVID-19 is covered in the situations listed and whether a party's non-performance falls within the scope of the clause.

A force majeure clause in an employment agreement may be more applicable to a fixed-term type of employment agreement, say employment for a specified event, rather than for a standard permanent employment agreement.

Frustration

New Zealand employment law allows for frustration of employment agreements – this may occur when an unforeseeable event makes it impossible for the parties to perform the obligations in the employment agreement. The effect of frustration on an employment agreement is that the employment is terminated – however, with COVID-19 it may be more appropriate to govern any termination of employment under existing redundancy provisions.

The New Zealand courts are reluctant to impose frustration on employment agreements, given the unequal effect this will have on affected employees. The COVID-19 situation likely will not give rise to frustration of many standard employment agreements, merely due to the workplace being closed – the work may be able to be carried out in adapted circumstances or a redundancy process may be more appropriate.

An employment agreement will not be frustrated where it contains express provisions to govern the situation (such as a force majeure provision mentioned above or other applicable leave provisions).

Part 5: Corporate governance

1. Introduction

The lock down has caused havoc for many companies as they have been forced to quickly adapt to different ways of working and often significantly reduced or no cash flow for a period.

The board of directors has ultimate responsibility for the management of the company and each director has duties under the Companies Act 1993 (**Act**) and common law. This part considers the duties of directors in the context of a cash flow crisis.

2. Summary of directors' duties

The duties of directors set out in the Act include:

- **good faith:** a duty to act in good faith and in the best interests of the company;
- **proper purpose:** a duty to exercise a power for a proper purpose;
- **compliance:** a duty to comply with the Act and the company's constitution;
- **reckless trading:** a duty to not agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors;
- **obligations:** a duty to not agree to the company incurring an obligation unless the director believes that the company will be able to perform the obligation; and
- **duty of care:** a duty to exercise the care, diligence and skill that a reasonable director would exercise.

The above is not an exhaustive list of the duties of directors. For example, a director has duties under the Health and Safety at Work Act 2015, which are also relevant in the context of COVID-19. In addition, the Act provides other duties in respect of certain disclosure requirements, restrictions on the use of company information, and other administrative obligations.

3. The duty of good faith

Section 131 of the Act states:[10]

> *"...a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company."*

This duty is subjective in nature and requires directors to act honestly and with a proper motive. Generally, it is presumed that the actions of directors have been made in good faith, unless those actions are ones that no director with an understanding of fiduciary duties would make.

The actions of directors will still be assessed against how people of business might be expected to act. Even if a director has an honest (but mistaken) belief that their actions are in the best interests of the company (and so may have a defence to a claim that they were in breach of the duty of good faith), such actions might be a breach of one of the director's other duties to exercise the care, diligence and skill that a reasonable director would exercise.

4. Reckless trading

Section 135 of the Act provides that a director must not agree, cause or allow the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

While this provision appears to be broad and onerous for directors, the Courts have held that the provision is concerned with substantial risk, rather than simply mere risk. Risk taking naturally accompanies the carrying on of any business. The preamble to the Act recognises this by stating that the purpose of the Act is: "to reaffirm the value of the company as a means of achieving economic and social benefits through the taking of business risks". Accordingly, when applying this provision, the Courts have drawn a distinction between "legitimate business risks" and "illegitimate business risks".[11] However, unlike the duty of good faith, this duty is objective. Subjective belief by a director that they are not trading recklessly is irrelevant.

While not an exhaustive list, several questions to be considered by directors at this time include:

- Are directors fully aware of the current financial position of the company and the company's likely prospects? Have proper and thorough enquiries been made?

[10] The section also provides exceptions for situations involving subsidiary companies and joint venture companies

[11] While this distinction has been applied extensively by the Courts, a recent authoritative decision has queried whether the concept of "illegitimate risk is the touchstone of liability itself".

- Is the company insolvent or close to insolvent? If so, in what sense is the company insolvent or close to insolvent (i.e. do liabilities exceed assets and/or is there an inability to pay debts as they arise)? Is the insolvency minor or substantial?

- What are the proposed actions? Do they include continuing to trade while insolvent, and if so, when will the company likely become solvent again?

- Will the proposed actions lead to a major risk of the company failing? If so, will there be a major deficiency on liquidation?

- How is the company capitalised? Is there sufficient financial support from shareholders? Is the support legally binding or not?

- Has legal and accounting advice been sought?

5. Obligations

Section 136 of the Act states:

> *"A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so."*

This duty has some overlap with 'reckless trading' and actions against directors will often argue breaches of both duties (among other breaches).

However, this section is not focussed on risk taking and the general conduct of directors when carrying on the business. Instead, it focusses on whether a director reasonably believes that the company will be able to perform specific obligations in relation to particular transactions and arrangements. Although, if insolvency is an issue, then this provision might apply more broadly to all transactions and arrangements.

If an action is brought against a director, the Courts will scrutinise both the director's subjective beliefs and the reasonable objective grounds for holding such beliefs.

6. Directors can rely on certain information and advice

Section 138 provides that a director, when exercising powers and performing duties, may rely on reports, statements, financial data, certain information and professional/expert advice (together, **advice**), provided that certain requirements are met. This includes advice that is prepared and given by:

- an employee of the company whom the director believes on reasonable grounds to be reliable and competent in relation to the matters concerned;

- a professional adviser or expert in relation to matters which the director believes on reasonable grounds to be within the person's professional or expert competence; and/or

- any other director or committee of directors upon which the particular director did not serve, provided that it is in relation to matters within the other director's or the committee's designated authority.

The director must also act in good faith, make proper inquiry where the need for inquiry is indicated by the circumstances, and have no knowledge that such reliance is unwarranted.

While not an exhaustive list, we provide several suggestions of actions that should be considered:

- These are particularly difficult times for many businesses and directors are facing issues which they have not experienced before. Navigating these issues will be outside the skillset and knowledge of many directors. Be humble and recognise your limitations and the need for advice from others.

- While the section allows directors to rely on employees, directors and committees of directors, this may not be an option if there is insufficient competence within the business. In addition, it may not be possible to establish reasonable grounds of reliance as those employees or directors who are being relied will be acting within difficult circumstances themselves, which may cloud their judgement (e.g. prospects of redundancy or loss of income, conflicts of interest, a tendency for directors to simply delegate (which does not absolve responsibility), and so on.

- Given the above, expert advice from independent professional advisors (i.e. lawyers, accountants, valuers, etc) may be the only advice that can be relied on. Such advice should be specific and tailored to the individual circumstances of the business (rather than general advice). When instructing advisors, directors should be honest when providing information and must not base such information on assumption which the director cannot rely on.

- Once advice is received, critically assess, question and test that advice and continue to do so. Directors cannot indiscriminately rely on advice, even when provided by experts.

- Reliance on advice for the purposes of attempting to limit one's liability will unlikely be made in good faith. Consider your motives in obtaining advice.

- Exercise due diligence. Review your corporate and business systems and your director's duties, follow up and monitor management to make sure that advice has been put in place, obtain further advice or second opinions where required.

- Create a thorough paper trail. Retain instructions to advisors and the advice received. Document the reasoning behind why the particular advice was sought, why the particular advisor was appointed (e.g. their qualifications and credentials, enquires that

were made to establish competence, etc), how you critically assessed the advice received, how you implemented the advice and continued to monitor, and so on.

7. Remedies for breaches of directors' duties upon liquidation

There are wide remedies available against current and former directors of companies upon liquidation. Broadly speaking, if it appears to a Court that a current or former director has been involved in misconduct in respect of the company's money or property, or has been negligent, or breached a duty in relation to the company, then the Court has wide powers. This includes making inquiries, repayment of money or property (with interest), or ordering directors to contribute to the company by way of compensation (which in some limited instances have exceeded the total losses of creditors plus liquidation and court proceeding costs).

The Act provides other remedies to various parties, including prior to liquidation. In addition, a breach of directors' duties may be an offence and significant penalties may apply.

8. Specific changes in relation to COVID-19

The current situation will present obstacles and directors may be unable to fulfil all their obligations and duties. The Government has recognised this and has rolled out (and continues to roll out) a package of schemes to assist businesses. At the time of publication, some schemes are in place (but have been revised) and others are yet to be implemented. Some of the changes still require legislation to be drafted and passed into law. Some of the changes will apply retrospectively. Accordingly, the summary below is only interim and directors should continue to monitor these developments.

By way of summary, some of the changes include:

- **Safe harbours in respect of insolvency related duties:** Proposed changes will create safe harbours for directors in insolvency circumstances. This is intended to provide a platform for businesses to continue to trade through and out of the COVID-19 crisis rather than prematurely winding up as a result of it. The changes will allow directors to decide to continue to trade over a six-month period without breaching their duties (in respect of reckless trading and obligations (discussed above)), provided that certain requirements are met. This includes: that the company was able to pay its debts as they fell due on 31 December 2019, and that the directors hold, in good faith, the opinion that the company faces or is likely to face significant liquidity problems over the next six months as a result of the COVID-19 crisis but that it is more likely than not that the company will be able to pay its debts as they fall due within 18 months. Other duties, remedies and offences will remain in place.

- **Business Debt Hibernation Scheme:** Under the proposed scheme, debtor companies (and other entities) will be able to make a proposal to its creditors, provided certain (currently unknown) thresholds are met. Creditors will then have a one-month moratorium period to vote on the proposal and creditors will be unable to enforce debts during that time. If 50% of creditors (by number and value of debts) vote in favour of the debtor's proposal, then it will apply (subject to any conditions imposed) and the

debtor will have a further six-month moratorium where debtors cannot enforce debts against the debtor. The Act currently provides similar options, although it is presumed that this will be more 'debtor friendly'.

- **Compliance with the Act and the company's constitution:** There will be temporary relief for companies (and other entities) who are unable to comply with certain obligations under the Act and the company's constitution (if any). For example, allowing the use of electronic meetings (even where the constitution does not allow for it). In addition, powers will be given to the Registrar of Companies to extend deadlines under the Act (e.g. dates for AGMs, filing annual returns, etc) and in relation to carrying out functions (e.g. processing times).

- **Business Finance Guarantee Scheme:** This scheme will provide short-term credit of up to $500,000 to small to medium sized businesses with turnover between $250,000 and $80,000,000 at the end of the 2019 financial year, provided that certain criteria are met. Broadly speaking, this includes that the business meets standard lending criteria of the lender, have exhausted other lending facilities (with the exception of certain types, such as, credit card debt, and trade finance loans), the business have urgent liquidity or bridging financial needs, the lending is not used to refinance debt (unless agreed by the lender), and is not related to certain excluded activities (e.g. property development and investment, processing whale meat, supplying recreational cannabis, weapons, tobacco, forms of agriculture, among others). In addition, there are several excluded purposes, including capital assets and projects (with some exceptions), financing dividends or on-lending outside the businesses' guaranteeing group, among others. Under the scheme, the Government will guarantee up to 80% of the loan shortfall, however, the lender will first need to pursue 100% of the shortfall from the borrower (and/or guarantors) and realise any security given in relation to the borrowing.

- **Voidable transactions:** There are proposals to change the claw-back period from two years to six months for non related-party transactions.

Again, some of the changes above are still to be drafted and passed into law. Accordingly, directors should continue to act within their existing duties and obligations until it is clear what the exact details of the changes will be. In addition, regardless of these changes and any relaxation of director duties, directors will still need to act in good faith and in the best interests of the company and exercise reasonable care, diligence and skill.

Even though the schemes above may be available, directors will need to consider whether these will assist the business to trade through the crisis or simply delay (and increase) the inevitable failure.

9. Recommended steps

The impact of COVID-19 has been significant and is rapidly changing. This may force directors into situations where they need to make decisions quickly. However, now is the time for directors to make a "sober assessment" of their company's potential future income and prospects. Make sure that cash forecasting is undertaken to properly understand the

prospects. Risks are high and such assessments should be thorough and repeated. Take enough time to fully and cautiously consider all options available to them (including having regard to their duties) and to take legal, tax, accounting or other advice where required. Decisions and the reasoning behind decisions should be thoroughly documented. Also, discuss the situation with stakeholders, including employees and banks.

Now is also the time to check your insurance policies (i.e. business interruption, credit insurance, D&O cover or other relevant policies). Notify your insurer as soon as possible (even if you are unaware of the loss) and follow their steps so as not to unintentionally void cover.

The decisions of many directors during the COVID-19 crisis will come to be scrutinised in the near future.

Part 6: Construction contracts

1. Introduction

Our experience was that COVID-19 first impacted procurement. Then, once the alert level increased to levels 3 and 4, most construction sites were shut down completely. In some cases, design (and other tasks which can be carried on remotely) continues but physical works have come to a standstill.

This part considers the effect of COVID-19 on construction contracts, with specific reference to NZS 3910[12]. Construction contacts based on NZS 3910 often contain special conditions which vary and/or add to the general conditions. Particular attention should be given to those special conditions to ascertain whether they are relevant in this context.

2. Suspension by the engineer

Once alert level 4 took effect some, but not all, engineers suspended works under clause 6.7.1, which states:

> *"If the suspension of the whole or a part of the Contract Works becomes necessary, the Engineer shall instruct the Contractor in writing to suspend the progress of the whole or any part of the Contract Works for such time as the Engineer may think fit, and the Contractor shall comply with the instruction."*

From a contractor's perspective, the advantage of a suspension is that it will be treated as a variation, entitling the contractor to an extension of time and time related costs. Conversely, principals may argue that the current situation does not constitute a suspension under clause 6.7.1, given that the site has been shut down by Government (not the engineer). In some cases, parties are taking a practical approach and agreeing to suspend the works, which is provided for in clause 6.7.5.

[12] NZS 3910:2013 Conditions of contract for building and civil engineering construction

If the suspension continues for more than 3 months, the contractor is able to request permission to continue the works. If the engineer does not grant permission within 1 month, then the contractor is entitled to treat the suspension as a variation (deleting the uncompleted portion of the works)[13].

3. Change of law

Clause 5.11.10 states:

> "*If after the date of closing of tenders the making of any statute, regulation, or bylaw, or the imposition by Government or by a local authority of any royalty, fee, or toll increases or decreases the Cost to the Contractor of performing the Contract, such increase or decrease not being otherwise provided for in the Contract, the effect shall be treated as a Variation.*"

There has been debate within the construction industry as to whether the various orders issued, and/or relied on, by Government in the fight against COVID-19 constitute the "*the making of any statute, regulation, or bylaw*". Unsurprisingly, many contractors are arguing that clause 5.11.10 does apply (entitling the contractor to a variation and corresponding extension of time and time related costs).

We understand the interpretation adopted by MBIE is that the various restrictions put in place, including the escalation to alert level 4, emanate from regulations or statutes meaning that clause 5.11.10 does apply. While this interpretation is not binding, it will be persuasive. You can read the statement released by MBIE here.

4. Advance notification

Under clause 5.21.1[14], both the contractor and engineer have an obligation to notify each other in writing as soon as they become aware of any matter which is likely to (among other things) materially alter the contract price or delay completion. Once notified, the contractor or engineer may require the other to meet (presumably including via electronic means) to explore proposals for avoiding or reducing the impact of the matter which has been notified[15].

The purpose of clause 5.21 is to encourage early communication so that the parties can work together to avoid or mitigate the impact of the matter (in this case COVID-19) as much as possible.

The failure of a contractor to promptly notify the engineer under clause 5.21.1 can cause any variation arising out of the matter to be valued as if advance notification had been given and the parties were able to avoid or reduce its impact[16].

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[13] Clause 6.7.4
[14] Clause references are from the General Conditions of Contract
[15] Clause 5.21.2
[16] Clause 5.21.3

5. Extensions of time

A construction contract typically permits the contractor to have more time to achieve completion in specified circumstances. In NZS 3910, the grounds for an extension of time are set out in clause 10.3.1, and include:

- the net effect of a variation[17];
- any circumstances not reasonably foreseeable by an experienced contractor at the time of tendering and not due to the fault of the contractor[18]; and
- default by the principal, which is not a variation[19].

A contractor is only entitled to time-related costs where an extension of time is granted under clause 10.3.1(a) (a variation) or 10.3.1(g) (a default by the principal)[20].

It seems unlikely that the consequences of COVID-19 were foreseen by the most experienced contractors even in the first few weeks of 2020. However, it will be more difficult for a party to claim an extension of time for contracts entered into since COVID-19 became widely known, given the impact of COVID-19 should have been foreseen (at least to some extent).

If the works have been suspended under clause 6.7 or clause 5.11.10 applies, the suspension or other effect is treated as a variation, entitled the contractor to an extension of time under clause 10.3.1(a) and time related costs.

6. Frustration

The doctrine of frustration should also be considered, particularly if there is no force majeure or extension of time clause that applies. NZS 3910 refers to frustration in clause 14.1.1, which states:

> *"In the event that either the Principal or the Contractor considers that the Contract has become impossible of performance or has been otherwise frustrated, one may notify the other that it considers the Contract to be terminated. If the other party agrees, or in the event of disagreement if it is so determined by the Engineer or by mediation or arbitration under Section 13, then 14.1.2 shall apply."*

A contract is not easily frustrated. While COVID-19 has made the performance of many construction contracts more difficult, delayed and/or more expensive, due to the very high

[17] Clause 10.3.1(a)
[18] Clause 10.3.1(f)
[19] Clause 10.3.1(g)
[20] Clause 10.3.7

thresholds of 'impossible' or 'radically different', we expect that the frustration of contracts will be less common.

Part 7: Electronic signatures

1. Introduction

The lock down imposed by the Government has affected the ability to get contracts and other legal documents signed and witnessed in person. Thankfully, the law provides the option for most contracts to be signed electronically, subject to meeting certain requirements and the exclusions.

2. The legal framework

The legal framework is set out in part 4 of the Contract and Commercial Law Act 2017 (**CCLA**). The general position is that where a signature is required by law, this can be accepted electronically provided certain conditions are met. The overarching condition will always be for the party receiving the electronic signature to consent to the document being signed electronically[21].

The CCLA requires the electronic signature to[22]:

- adequately identify the signatory and adequately indicate the signatory's approval of the information to which the signature relates. This includes making sure the signatory's name is printed clearly next to their signature, and if applicable, records what capacity the signatory is signing on (i.e. as director of a company); and
- be as reliable as is appropriate given the purpose for which, and the circumstances in which, the signature is required.

In most circumstances, an electronic signature will be presumed to be reliable as is appropriate if[23]:

- the means of creating the electronic signature is linked to the signatory and to no other person;
- the means of creating the electronic signature was under the control of the signatory and of no other person;
- any alteration to the electronic signature made after the time of signing is detectable; and

[21] Sections 226(2) and 227(2) of the CCLA
[22] Section 226 of the CCLA
[23] Section 228 of the CCLA

- where the purpose of the legal requirement for a signature is to provide assurance as to the integrity of the information to which it relates, any alterations made to that information after the time of signing is detectable.

3. What documents cannot be signed electronically?

Schedule 5 of the CCLA provides a list of documents which cannot be signed electronically, including:

- wills, codicils or other testamentary instruments;
- powers of attorney;
- affidavits; and
- statutory declarations.

On 3 April 2020, the Government announced its intention to make changes to the CCLA which will allow security agreements containing powers of attorney to be signed electronically.

4. Digital versus electronic signatures

An 'electronic signature' is defined as 'a method used to identify a person and to indicate that person's approval of that information.'[24] This wide definition means that an electronic signature may include:

- an email sign off;
- clicking an 'I Agree' checkbox (for example, accepting terms and conditions on a webpage before proceeding);
- signing a paper document and sending back a scanned copy via email;
- signing an electronic document on a touch screen device using your finger or a stylus;
- copying and pasting a picture of your handwritten signature onto a document;
- typing your name; and
- a digital signature.

Digital signatures are more sophisticated than other types of electronic signatures. They use authentication tools to generate a digital signature, verify the signatory, and secure the signature by encryption. These features mean digital signatures have greater integrity than

[24] Section 209 CCLA

other forms of electronic signatures. Examples of providers of digital signature services include ADLS Webforms digital signing and DocuSign.

More information

If you have any questions or would like advice in respect of any legal matter you are facing (whether related to COVID-19 or not), please get in contact with us.

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