NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Primary Production Committee

on the

Farm Debt Mediation Bill

14 August 2019

NEW ZEALAND BANKERS ASSOCIATION
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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following seventeen registered banks in New Zealand are members of NZBA:

- ANZ Bank New Zealand Limited
- ASB Bank Limited
- Bank of China (NZ) Limited
- Bank of New Zealand
- MUFG Bank, Ltd
- China Construction Bank
- Citibank, N.A.
- The Co-operative Bank Limited
- Heartland Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- Industrial and Commercial Bank of China (New Zealand) Limited
- JPMorgan Chase Bank, N.A.
- Kiwibank Limited
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited
- Westpac New Zealand Limited

Background

3. NZBA welcomes the opportunity to provide feedback to the Primary Production Committee (**Committee**) on the Farm Debt Mediation Bill (No 2) (**Bill**) and commends the work that has gone into developing the Bill. NZBA made submissions on the first Farm Debt Mediation Bill (introduced 15 May 2018 – now withdrawn) (**Earlier Bill**). NZBA appreciates the consideration the Committee has already made in respect of the feedback we provided on the Earlier Bill.

4. If you would like to discuss any aspect of the submission further, please contact:

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Introduction

5. NZBA remains supportive of the purpose of the Bill, which is stated in Section 3 of the Bill to provide a process for mediation to occur in order to explore turnaround or exit options, before a creditor who holds security over core farming assets seeks to enforce that security. NZBA members recognise the importance of a strong relationship between a bank and its agribusiness customers and are willing to implement mechanisms to support this relationship.

6. Since New Zealand's banks were first established in New Zealand, they have worked with farmers and the rural community. They know it's a unique business that can be incredibly tough in the short term but with perseverance can be incredibly successful.

7. Banks believe it's important to stand by the rural sector in tough times and work with farmers to ride them out. They have demonstrated this in recent years during the PSA kiwifruit outbreak and the dairy downturn.

8. According to mortgage data in the last five years there were 45 mortgagee farm sales, an average of nine a year. Given there are 52,000 farms in New Zealand, that accounts for less than .02% of farms in the country each year.

9. Banks work very closely alongside their primary sector customers from the beginning, when signs of financial stress become clear. This is the best way to avoid problems escalating.

10. That close working connection is especially the case if a farmer shows real signs of financial stress. While each bank has different policies and plans, banks go through a series of steps and try different options to reach a mutually acceptable resolution to avoid enforcement action where possible. The typical life cycle generally comprises:

    - early discussions upon identification of potential issues;
    - if the situation deteriorates, further monitoring of performance and management of working expenses and efficiencies, and development of turnaround strategies with the customer;
    - if the situation continues to deteriorate or does not improve as planned, independent review and implementation of the reviewer's recommendations (which may include deleveraging);
    - if the situation deteriorates further, the parties may have difficult conversations to try to reach agreement on the steps available to the customer to overcome the difficulties within the business. If resolution cannot be reached despite best endeavours, enforcement would be the last resort.

11. Working through a financial distress situation can take from six months to up to five years. In most cases legal advocates and the rural support network are involved in this process.

12. Farm debt mediation, which would bring consistency and clarity of the process for both the farmer and bank, is something the industry supports. It may well also

shorten the amount of time taken to get to a resolution and avoid the need for creditor enforcement as a last resort.

13. Consistent with its members' pro-active and cooperative approach to dealing with distressed agribusiness customers, NZBA made detailed submissions on the Earlier Bill to ensure that the underlying purpose of the legislation was reflected by the application of that bill. In addition, prior to the introduction of this Bill, NZBA had been advancing a farm debt mediation scheme with its members based on the Australian experience of farm debt mediation. Most Australian states have legislated to provide for a farm debt mediation scheme[1] and their experience indicates that the farm debt mediation scheme can be effective and beneficial for both creditors and farmers. On the introduction of the Bill, NZBA has been focused on considering the optimal form and content of equivalent legislation.

14. We understand that some lenders to agribusiness operations may not have such processes in place or treat such enforcement mechanisms as last resort and therefore this Bill seeks to set a minimum standard for lenders generally. The Bill's application to second and third tier lenders or lenders of last resort is a real practical benefit for farmers.

15. NZBA would welcome the opportunity to discuss in more detail its submissions with the Committee.

16. This submission will address the following points:

    (a) Discussion of key concepts that apply – good faith exceptions to the restrictions on enforcement, confidentiality, and multiple creditors;

    (b) Key definitions in the Bill, focusing on terminology that requires clarity;

    (c) Mediation process; and

    (d) Various miscellaneous drafting and process matters.

17. NZBA appreciates that regard has been primarily made to the Farm Debt Mediation Act 1994 (NSW) (**NSW Act**) and to some extent, the Farm Business Debt Mediation Act 2017 (Qld) (**Qld Act**) and Farm Debt Mediation Act 2011 (Vic) (**Vic Act**). However, the Bill needs to also take into account its application in NZ's unique farming and banking context. Therefore, although the Australian statutes provide a helpful foundation, NZBA's submissions overlay that starting point with other factors based on members' vast industry experience. The suggestions for change to the Bill made by NZBA are with a view to ensuring that the Bill meets its stated purpose and stakeholders' expectations.

Good Faith

18. To ensure a successful mediation process, parties generally voluntarily enter into a process in good faith and an open mind to resolving the issues. Given we are reconciling this position with a new compulsory scheme, it is of fundamental importance that all the parties engage in the entire process in good faith. NZBA submits that it would assist all parties if there were certain amendments in the Bill to manage expectations on what constitutes good faith.

[1] See for example the Farm Debt Mediation Act 1994 (NSW) and the Farm Debt Mediation Act 2011 (Victoria).

19. First, NZBA submits that the current s24, which refers to mediating or "participat[ing] in the mediation" in good faith should be moved to an earlier part of the Bill to emphasise that this philosophy underpins the entire process – that is, rather than acting in good faith on "mediation day", their actions throughout the mediation process should be dictated by this obligation, including:

(a) agreeing whether to mediate and on who the mediator will be;

(b) agreeing on the procedural matters with the mediator;

(c) meeting timeframes and not unnecessarily delaying matters; and

(d) actions and behaviour in the interim – that is, farmers continuing to comply with legal obligations to the best of their ability and ensuring that the secured creditor's interests in the secured property remains protected and not deliberately put at risk.

20. Therefore, in addition to moving s24 and ensuring that it applies to the mediation process as a whole, NZBA submits that further examples (in addition to s24(2)) should be included as guidance of what does or doesn't constitute lack of good faith:

What may constitute lack of good faith

(a) Further material or deliberate breach (or concealment of a breach) of the security agreement or any other contract between the farmer and secured creditor. (We note that generally a farmer will be in breach of their contractual obligation if a farmer does not insure and maintain secured property, puts any secured property at risk (including under s109(2) of the Personal Property Securities Act 1999 (**PPSA**)), there is a distress, execution, attachment or other legal process relating to the secured property, or a local authority or governmental agency takes action under the Resource Management Act 1991 or other enactment relating to the use of land or the environment);

(b) Unreasonably delaying the progress of a mediation (for example, by lack of communication or delaying provision of material information);

(c) Directing income payments into another account, that is an account of a related party outside of the charging group or to an account with another bank;

(d) Dishonesty about material/significant matters;

(e) Deliberate breach of confidentiality;

(f) Making a serious threat to the safety of a creditor/representative;

What may not constitute lack of good faith

(g) S24(2) of the Bill; and

(h) declining to provide further funding.

21. In addition, the circumstances referred to in s19(2) and 20(5) should be deemed to be circumstances where the relevant party has declined to mediate (for the

purposes of s32(a) and s33(c)). This also means that s20(5) should be amended to say "The following may be treated as evidence that a party has not participated in the mediation process in good faith."

22. Under s24 the word 'failure' to reduce or forgive debt is not appropriate. The more appropriate term would be a creditor 'declining' to do so.

Exceptions to the restrictions on enforcement

23. The Bill needs to provide for a mechanism for Banks to act with urgency in certain situations as set out below:

    (a) where collateral is at risk of damage or destruction,

    (b) environmental non-compliance,

    (c) crop wastage,

    (d) misappropriation of assets,

    (e) concealment from a creditor,

    (f) where a farmer requests enforcement action,

    (g) or where there are animal welfare concerns.

    In such emergency situations, creditors should be able to bypass the mediation process as an interim measure, or obtain an emergency enforcement certificate (issued within, say, 24 hours) (or alternatively, a Court order) to enable the creditor to preserve the status quo. We emphasise that this measure is interim only to preserve the security and/or its value.

24. Alternatively a creditor could apply for a protection order on the grounds set out above. The creditor could apply for this order at the same time as applying for an enforcement order or requesting mediation. The order would permit the creditor to take specified actions to avert those risks while mediation continues.

Confidentiality

25. The importance of confidentiality is uncontroversial. Parties should be free to discuss all matters fully and frankly to ensure the best chances for reaching a negotiated settlement. S26 should also expressly cover the confidentiality of the pre-mediation process, for example documents exchanged. In addition, the general requirement of confidentiality should only be able to be expressly overridden by a procedure or other agreement (amend s26(2)).

26. NZBA does not object to the mediation report being provided to the chief executive, so long as the Bill's provisions are consistent with parties' expectations of strict confidentiality. Although it is not envisaged that it would be disclosed to any other parties at this stage, it would also be prudent for s25 to provide for parties to the mediation having an opportunity to submit objections against disclosure. Also in respect of provision of the mediation report, NZBA recommends that the report also be made available to the parties (with parties also being expected to keep this document confidential) at the same time as being provided by the mediator to the Chief Executive.

27. NZBA submits a clause be included that says nothing in the Act affects the law on privilege. Provision of the mediation report to the Chief Executive should not constitute a waiver.

Multiple creditors

28. The Bill is silent on the situation where there are multiple creditors and there is an assumption that each creditor must act independently of other creditors. This may not be practical or efficient and further thought is required as to how multiple creditor mediations can be managed in practice.

29. NZBA recognises that there will be secured creditors who wish to enforce on, for example, one piece of rapidly depreciating mobile farm machinery of relatively low value. In this case, the creditor would theoretically be obliged to engage in the full process, which may involve a disproportionate time and expense. Balancing the need for a level playing field between creditors with commercial practicality, NZBA would not be opposed to a *De Minimis* amount, below which the property would not constitute farm property.

30. NZBA suggests that parties contemplate whether other creditors should attend the mediation (in part or in whole) during the procedural agreement stage. These could include other secured creditors (like asset and stock financiers) or unsecured creditors (like the Inland Revenue Department), who would fall under "interested parties" (s20(3)(a)(b)). Anecdotal evidence from Australia suggests that there has been some success in a farm debt mediation where other creditors have been involved.

Key Definitions

31. The definition of key terms should be closely scrutinised, given interpretation of those terms is crucial in determining whether compulsory mediation applies.

"Primary Production Operation"

32. The definition of primary production operation is a linchpin as it is referred to in the definitions of "farm debt", "farm property" and "farmer". The definition in the Bill appears to be based on the NSW Act definition of "farming operation".

33. The definition of "primary production operation" is wide enough to incorporate agricultural contracting businesses, although this was likely not intended. These are businesses that provide services (such as cultivating, planting, baling, harvesting and silaging) to various farming operations, although they are not ordinarily considered as farmers in the usual sense. NZBA submits that there should be an express exclusion of these service providers in the Bill. NZBA members understand that the position may not be entirely clear in Australia in terms of strict statutory interpretation, but it is generally understood (but untested) that the legislation is not intended to protect contractors.

34. NZBA also submits that the catch-all at clause (a)(iv) may be problematic in future:

> …means a business undertaking that primarily involves 1 or more of the following activities: an activity involving primary production that is carried out in connection with 1 or more of the activities set out in subparagraph (i) [agriculture (including sharemilking)], (ii) [horticulture], or (iii) [aquaculture].

35. The wording of the catch-all should be considered more carefully or alternatively, simply removed - refer to Qld Act (definition of "farming business") or Vic Act (definition of "farming operation"). If it is to be retained, we would suggest that it is amended to make it clear that it only applies to primary production activities which are undertaken by the same farmer who is also engaged in activities in subparagraph (i) so as to avoid inadvertently capturing (for example) third party contractors who provide services to farming enterprises.

"Farmer"

36. NZBA understands the key rationales for affording farmers greater protection can be summarised as follows:

    (a) vulnerability to conditions outside of their control (for example, adverse weather, natural disasters or biosecurity incursions);

    (b) the family home being integral to the business;

    (c) likelihood of financial stress also affecting farmers' mental wellbeing, animal welfare and environmental issues; and

    (d) imbalance in negotiating power.

37. Based on this rationale, NZBA proposes excluding institutional farmers and farming operations owned or controlled by a listed company from the definition of "farmer". These entities do not need the protection mechanism intended by the enactment of the Bill – in the vast majority, the family home is not integral to the business of institutional entities and they also have extensive resources and sufficient bargaining power to negotiate with creditors.

38. The exclusion of institutional entities could potentially be incorporated with reference to either a net asset test, debt level or a turnover/revenue test, with operations above a certain level, for example, $20 million of debt and/or $10 million of annual turnover, not captured. NZBA does not consider that collectively owned entities will be prejudiced by this exclusion, but if the Government is concerned about specific collectively owned entities (for example iwi and hapū owned businesses) then these businesses could be specifically excluded.

39. There are instances where the farm owner is no longer physically farming the security property but either leasing the farm to a third party or employing a sharemilker / contract milker. The expectation around this arrangement should be set out within the Bill – that is, is this seen as a farming operation or property ownership / operation? This could become more of issue in the future where farmers retain ownership of their farm when they retire, and lease rather than sell.

"Farm Property"

40. The definition of "farm property" is all-encompassing:

> …any property that is used for or in connection with the primary production operation of the farmer.

41. NZBA suggests applicability of a farm property definition being subject to a *De Minimis* amount. Please refer to the separate bank submissions for suggested levels.

"Enforcement action"

42. NZBA submits that the wording of the catch all in the definition of "enforcement action" at (b)(vi) (set out below) is unhelpful and should be deleted:

> …exercising, as creditor or as a receiver or person so appointed, a right, power, or remedy existing because of the security interest, whether arising under an instrument relating to the security interest, under a written or unwritten law, or otherwise.

43. There does not appear to be an equivalent of this sort of catch-all in the NSW, Qld and Vic legislation but rather, those jurisdictions use definitions focussed on "taking possession" or any other "action to enforce".

44. NZBA members' security and facility agreements include rights such as issuing breach notices, demands (not just "reminders to pay" as illustrated in the Bill's example), lodging caveats, exercising set off rights, requiring further information (including independent advisors' report), entering into premises to inspect security, ensuring security is adequately insured, and acquiring information from 3rd parties. These actions may be captured as "right[s], power[s], or remed[ies] existing because of the security interest" but should not be part of the definition of enforcement action. Further, NZBA understands that mediation is not a prerequisite to taking these steps in Australia and submits that this should be the same in New Zealand.

45. Most of the examples of actions noted at paragraph 44 above assist with gathering accurate and reliable information or protecting creditors' interests in security. To continue working with a distressed farming business and agree to a realistic ongoing strategy, lenders need these tools to ensure a good understanding of the farmers' financial position and also be able to monitor subsequent progress.

46. In circumstances where both the farm and creditor are of the same view, there should be an option for the farmer and creditor to reach an agreement to contract out of the Act under s56, but the Ministry would have to be notified. An example would be where a farmer requests enforcement action.

Mediation Process

47. In general, NZBA is supportive of the proposed general process, but makes further comments bellow.

Timeframes

48. In the spirit of parties proceeding with the process in good faith, NZBA considers that the 20 working days provided for acceptance of a mediation request is reasonable. However, the ability to extend for an additional 20 working days could be excessive and have adverse implications. In practical terms, this would give very little time for the mediation process to be completed within the default 60 working day timeframe. The timeframe should be reduced to 10 working days.

49. Subject to mediation occurring as soon as practicable in the circumstances and the good faith obligations applying to the entire process, NZBA does not object to the 60 working day timeframe (extendable by agreement).

50. However, NZBA submits that maximum timeframes for issuance of certificates and decisions on administrative reviews should be included in the Bill (rather than "as soon as practicable" – ss38(1) and 53(1)). A reasonable timeframe is 5 working days. We have concerns that without a deadline on the Chief Executive of MPI to

provide written notice to the applicant and the other party of his/her decision, parties could face unnecessary uncertainty and delay. This could have serious ramifications for animal welfare, biosecurity and environmental risks.

Commencement of process

51. NZBA supports mediation being commenced by either request by the farmer or creditors (in the event there is a default). In the event of a farmer-initiated mediation, a creditor could technically apply for an enforcement certificate in the event it participated in good faith (s32(b)). However, given the process was not creditor initiated, a creditor may be content to not apply for an enforcement certificate if it is for the benefit of the ongoing relationship and banking arrangements. In those circumstances, it is reasonable to impose a restriction on the number of times a farmer can request mediation - NZBA suggests that a subsequent farmer-initiated request for a formal mediation on the same issue under the Bill can only occur after 3 years (to align with the 3-year efficacy of the enforcement certificate). However, NZBA emphasises that continual discussions and negotiations between lenders and with their farming customers is the norm in a banking relationship and in the event there is a dispute that warrants having a formal process with an independent "circuit breaker" involved, members would actively encourage mediation (regardless of the statutory scheme).

52. Similarly, the Bill does not prevent a farmer or creditor from issuing a mediation request in circumstances where a mediation agreement is in effect, which raises the possibility of mediated settlements being subsequently reopened. It would seem counterintuitive, where the parties have successfully agreed a mediation agreement, for those parties to seek enforcement or prohibition certificates to prevent further mediation of the issues. Rather, s14(2) and 15(2) should be amended so that a mediation request may not be made where there is a mediation agreement in effect between the parties.

Acceptance

53. Where the farming operation is operated by two or more persons (for examples, partners in a partnership), internal disputes can be problematic. NZBA submits that the Bill should make clear that an internal dispute should not hold up the mediation process. Therefore, in the context of s18(c), NZBA considers that failure of a multiple-party farming operation to agree on whether to proceed should be included as an example that they do not want to proceed with mediation. In this situation, a creditor should be able to proceed with applying for an enforcement certificate if required.

54. It is not unusual for farmers to operate their farming business across a number of companies, partnerships and/or trusts. Where there are multiple entities controlled by the same farmer(s), it would be more efficient if there were provisions in the Bill so as to allow for mediation requests to be consolidated with a view to a multi-party mediation across those entities.

Appointment of mediator

55. NZBA submits removing the option of the farmer nominating a panel of 3 mediators for selection by a creditor, as in sparsely populated rural areas there are fewer mediators and more chances of potential conflicts of interest. Instead NZBA submits the following alternative options:

(a) allowing parties to agree on an authorised mediator. Given their experience, NZBA members will continue to have regular discussions with industry experts and it may be expected that creditors may therefore have an informed view on which mediators would have specific expertise and rural banking knowledge that may be better suited to certain circumstances or issues; and

(b) in the event agreement cannot be reached, the Chief Executive may appoint an authorised mediator. In rural areas, farmers have relationships with particular law firms or accounting firms. NZBA appreciates that s45 is aimed at eliminating conflicts of interest. However, in circumstances where this continues to be an issue (or the parties cannot agree on a mediator for any other reason), the Chief Executive should be able to step in and appoint a different mediator.

56. The process for selecting a mediator under the Bill differs from the approach under the New South Wales legislation. The cabinet approval paper for the Bill indicates that the process in the Bill is based on the equivalent process under the Construction Contracts Act 2002 (**CCA**). However, we note that the process for selecting adjudicators under section 33 of that CCA aligns with the process suggested above – the parties first seek to agree an adjudicator and if that person cannot be agreed on (or is not available), an independent nominating body selects the person to act as adjudicator. It is suggested that a similar approach to selecting a mediator under the Bill will be more likely to ensure that an impartial and competent mediator is selected, than a process which allows for the pool of three potential mediators to be determined by one party.

57. NZBA agrees that it is sensible to proceed with agreement on procedural matters, as contemplated by the Bill. In the interest of proportionality and practicality, it would be helpful to add under s20(3) that one of the matters that the parties could agree on, if appropriate, would be remote attendance at mediation. Although NZBA members would generally attend mediations in person, it may be helpful in some circumstances (for example, where security held is relatively low value) for parties to turn their minds to the option of mediation by video conference or telephone.

Mediation agreement

58. NZBA understands that the requirement for the mediator to prepare the mediation agreement mirrors the equivalent NSW legislation. However, members would like to preserve flexibility to the most pragmatic course of action in the circumstances, for example the creditors' or farmers' counsel preparing the agreement for the mediators' approval. This optionality should be built into the wording: "The mediator <u>(or any other mutually agreed party)</u> must prepare a draft mediation agreement…"

Cooling off period

59. NZBA does not object to the 10 working day period allowed for farmers to cancel the mediation agreement (referred to as the "cooling off period" in NSW). However, in NSW the parties are able to expressly waive or vary this period by agreement – this may give parties the ability to enter into a more workable agreement to suit their circumstances.

Enforcement

60. NZBA does not agree that applications for enforcement or prohibition certificates should be time bound, with the time being started when the grounds for application have been triggered (s34(1)). This does not recognise the commercial reality of the relationship between creditors and farmers, which may involve continual negotiations post-mediation, with the parties still striving to reach an agreement in good faith. The additional time pressure may force creditors to unnecessarily apply for enforcement certificates to avoid "missing the boat" in circumstances where they may be trying to reach a mutually workable solution, thereby unnecessarily impacting negotiations in a negative way. Alternatively, it may cause parties to unintentionally prejudice their positions if they were continuing to negotiate in good faith. Therefore, the 10 working day period should be extendable upon application to MPI if it is reasonably justified.

Administrative Review

61. NZBA agrees that it is prudent to include the ability for parties to have a certification decision administratively reviewed. It should be considered whether the review should be undertaken by a separate body, rather than the Chief Executive.

62. A stay of enforcement during this time may also be appropriate in circumstances to avoid any review outcome being nugatory. However, given the time that has already elapsed, the Bank is concerned to avoid the further deterioration of the farmers' circumstances. NZBA refers to its submission recommending a 5-working day timeframe at paragraph 50 above.

Guarantors

63. NZBA notes that under s57, guarantors who have guaranteed farm debt are also to be treated as "forming part of that farm debt" and accordingly, the restriction against enforcement applies to any enforcement action under "a security interest granted by the guarantor" in connection with that farm debt. However, it does not expressly provide that the guarantors are required to attend the same mediation as the borrower farmer.

64. NZBA submits that the Bill should expressly provide that guarantors are required to attend mediation with the borrower, given their debt forms part of the borrower's farm debt. NZBA recognises that in some circumstances, this may not be achievable in practice. In that case, separate arrangements can be made at the procedural agreement stage.

65. Furthermore, the restriction under s57 on enforcement action should be amended to refer to "a security interest <u>over farm property</u> granted by the guarantor in connection with that farm debt". Consistent with section 10(3), creditors should not be restricted from taking enforcement action against guarantors in relation to non-farm property, particularly as non-farm property may often secure non-farm debt owed by the guarantor directly to the creditor (as well as securing obligations under the guarantee).

Miscellaneous

66. Given the timeframes applicable under the Bill and the infrequency of postal delivery in rural areas, it would be preferable if the Bill (or the published requirements under

s60) made provision for delivery of mediation requests and other notices under the Bill by email.