

Farm debt mediation scheme

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The Government has now announced its intention to proceed with the introduction of a bill to establish a farm debt mediation scheme, based in many respects on comparable New South Wales legislation. It is important for secured lenders to farming enterprises to consider in advance the implications of the bill and the necessary changes to product design, documentation, client relationship management and enforcement processes which may be required.

The scheme is intended to provide for fair, equitable and timely resolution of farm debt issues with two key objectives:

- For farmers and secured creditors to meet in an equitable manner to constructively and objectively explore options for business turnaround
- To provide for a timely and dignified exit for those for whom few other options exist.

In particular, parties will be required to engage in (or attempt to engage in) statutory mediation under the scheme before the creditor can take enforcement action in relation to farm property. Secured creditors and farmers are not required to reach agreement through mediation – if agreement cannot be reached, a secured creditor will be able to apply for an enforcement certificate from Ministry of Primary Industries (MPI) in order to proceed with enforcement action, provided that the secured creditor acted in good faith during the mediation. We expect that MPI will place considerable reliance on the report provided by the mediator, in determining whether the secured creditor acted in good faith.

The scheme will be administered by MPI, who will be responsible for issuing enforcement and prohibition certificates, and for overseeing approved mediator organisations (who will in turn supervise authorised farm debt mediators).

The key features of the scheme are summarised in the schedule attached to this note.

Notwithstanding the focus on bank lending to dairy farms in recent media reports in connection with the bill, it is important to note that the application of the scheme is not so narrowly confined. As drafted, the scheme will broadly apply to farming operations engaged in agriculture, horticulture and aquaculture (and associated primary production), and may be further expanded in the future by regulation (for example, to include forestry). The scheme will capture secured non-bank lenders and farm equipment financiers, but will not apply to unsecured creditors (including trade creditors and the IRD). Enforcement of security given by guarantors in relation to farm debt will also be subject to the scheme.

Issues for consideration

There are aspects of the bill which we consider could be improved upon during the Select Committee process:

- The bill should distinguish between family owned and operated farms – whose interests the bill is primarily concerned to protect – and major corporate, institutional or listed farming operations, who are sophisticated counterparties which could reasonably be expected to have sufficient bargaining power to reach a negotiated solution with their secured lender, without the assistance provided by the scheme
- Clarity as to the extent of the types of farming operations covered by the scheme (whether agriculture, horticulture or aquaculture) would be welcomed. It is not clear, for example, whether viticulture or beekeeping would be captured
- The mediation process under the bill could be expected to take a number of weeks or months to complete, assuming that a mediator is available and both parties commit to the process. The bill does not have a procedure to deal with circumstances of urgency (including, for example, destruction of property, animal welfare, biosecurity or other risks) which may, in the absence of co-operation from the farmer, justify immediate enforcement action to address those risks and preserve security value. An ability to apply to MPI or the Court for permission to enforce in those circumstances may assist in that respect
- The bill includes, in the definition of enforcement action restrained by the moratorium, the issuing of notices under section 119 or 128 of the Property Law Act. In our view, the bill should allow for those notices to be issued and run concurrently with the mediation process under the scheme
- There may be situations where a farmer willingly (and with the benefit of legal advice) consents to enforcement action, or invites the appointment of receivers, in circumstances of hopeless insolvency. While the bill does not permit contracting out of the scheme, it should be permissible in those circumstances to allow for immediate appointment without the necessity of seeking an

enforcement certificate

- The bill does not address the possibility of multi-party mediation, either in relation to multiple farming entities (controlled or owned by the same farmer) or multiple secured lenders
- It is not clear under the bill as drafted whether the extension of the moratorium on enforcement action to guarantors of farm debt is intended to prevent enforcement against non-farm property (as opposed to farm property only) owned by those guarantors.

Going forward

At a documentation level, lenders will need to review and consider what changes may be necessary for their agri-loan exposures, taking into account the additional time and processes that will be required before enforcement action can be commenced. The mediation process stands the best chance of producing an effective restructuring outcome if it is commenced well in advance, rather than left to a point in time where the farmer is hopelessly insolvent and enforcement is a foregone conclusion. Accordingly, as creditors may only initiate mediation following a default, financial covenants and other 'early warning' triggers should be reviewed with a view to ensuring that they are set at a level which will allow time for the mediation process to be conducted. Grace or standstill periods should also take account of the likely time periods involved in the mediation process, particularly if the scheme, when enacted, requires Property Law Act notices to be issued after (rather than alongside) the mediation process.

The bill will apply to all farm debt, including existing farm debt at the time of establishment of the mediation scheme. The restriction on enforcement action will not apply where the action was commenced prior to the restrictions coming into force.

MPI have indicated that the bill is expected to become law by the end of the year, with the mediation scheme to be available from 1 October 2020. There will be an opportunity to make submissions on the bill during the Select Committee stage.

Features of the farm debt mediation scheme

Scope: The scheme applies to debt (farm debt) incurred solely or principally for the purpose of conducting, and to security (farm security) in property used in connection with, a business undertaking primarily involved in agriculture (including sharemilking), horticulture or aquaculture (or an activity involving primary production in connection with any of those activities).

Moratorium on enforcement: A creditor cannot take enforcement action (including service of Property Law Act notices, appointment of a receiver or exercising a power of sale) in relation to farm property unless:

- The creditor has an enforcement certificate which is in force (for 3 years from the date of issue)
- The farmer does not have a prohibition certificate which is in force (for 6 months from the date of issue).

Enforcement and prohibition certificates are issued depending on the outcome of the mediation process (see below).

The moratorium on enforcement does not however apply where:

- The parties have entered into a mediation agreement under the scheme in the last 3 years (in which case, the terms of the mediation agreement will govern when enforcement can occur)
- A farmer becomes subject to an insolvency proceeding (such as liquidation, bankruptcy, voluntary administration or receivership).

Initiating mediation: A farmer can request mediation with a creditor in relation to farm debt at any time, provided an enforcement notice is not in force. A creditor can request mediation with a farmer in relation to farm debt at any time after a default has occurred, provided a prohibition notice is not in force. Parties are not obliged to mediate, however if a farmer declines to mediate a creditor may apply for an enforcement certificate, and similarly a farmer may apply for a prohibition certificate if a creditor declines to mediate. Failing to reply to a mediation request within 20 working days is treated as declining to mediate.

Mediation process: Once an invitation to mediate is accepted, the creditor must agree to one of three authorised mediators nominated by the farmer. Costs are to be shared equally unless otherwise agreed (provided that the farmer cannot be responsible for more than half of the costs).

Once a mediator is appointed, the parties and the mediator are required to enter into a procedure agreement, relating to the processes under which the mediation will be conducted. The parties are obliged to participate in the mediation in good faith. A failure by a creditor to agree to reduce, forgive or vary the terms of its debt does not of itself demonstrate a lack of good faith.

There is a 60 working day timeframe within which to complete the mediation process (unless the parties agree an extension), during which time the restriction on enforcement action remains in force. At the end of the mediation process, the mediator will provide a summary report to MPI.

Outcome: Any agreement reached by the parties in mediation is to be documented in a mediation agreement, a draft of which is to be prepared by the mediator. There is a 10 working day cooling off period in which the farmer may cancel the mediation agreement.

Certificates: A creditor may apply to MPI for an enforcement certificate where the farmer has decline to mediate, or the creditor has participated in mediation in good faith (even where a mediation agreement has not been reached, or has been cancelled). A farmer may apply to MPI for a prohibition certificate where the creditor has declined to mediate, or the creditor has not participated in the mediation in good faith.

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