Your Ref:
Our Ref: Denis McMahon
Date: 28 August 2017

Stephen Palethorpe
Secretary
Select Committee on Lending to Primary Production Customers

Dear Mr Palethorpe

Questions of Notice - Legal Aid Queensland
Senate Inquiry into Lending to Primary Production Customers
Dennis McMahon

We have reviewed the transcript provided to Legal Aid Queensland following Denis McMahon's attendance at the Select Committee's Public Hearing in Roma, Queensland on Wednesday 2 August 2017.

We have identified the following typographical errors in the transcript:

- Page 16 - Response of Mr McMahon:

  "The difficulty that I have and also my clients have is that, when receivers are appointed, there's very little contact between ourselves and the receivers. Any information that they might glean in relation to valuations or sales that are processed is given to the agents that they appoint. The clients aren't privy to those discussions. I believe I've been told by bank officers that they will obviously get the valuations prior to proceeding to sale and that, if the property has been properly advertised—for example, in Queensland Country Life—and given the exposure that would normally be required for a property of that nature and at auction or sale the property doesn't reach valuation, they have discussions with the valuer and explain the process that they've been through to see whether the valuer will agree that this is appropriate and the current market is saying this is the value that the property is going to be able to achieve. That's anecdotal evidence because I'm not privy to those discussions."

  There appears to be a transcription error with the second and third sentences which should read as one sentence. Please see the following:

  > Any information that they might glean in relation to valuations or sales with the agents they **appoint, the clients** aren't privy to those discussions.

A. Senator Roberts - Questions on Notice

On 14 August 2017 Legal Aid Queensland received from the Select Committee a list of questions on notice issued by Senator Roberts. The reply to these questions is set out below.

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1. Re Post inquiry Monies, can you recall Ronald Feierabend's case south of Gin Gin about Aug/Sept 2015

Legal Aid Queensland (LAQ) and its employees are subject to strict obligations of confidentiality and secrecy under sections 75 and 82 of the *Legal Aid Queensland Act 1997*. LAQ cannot disclose any information relating to individuals. LAQ can provide general answers relating to the law which are set out below.

2. Can you explain how the law is applied when using personal injury money when borrowing against collateral?

The Bankruptcy Act 1966 provides that certain types of rights to recover damages or compensation for a personal injury or wrong done to a bankrupt do not vest in the trustee in bankruptcy. These funds are protected and not available for distribution to creditors and are retained by the bankrupt. There are exceptions to this rule such as compensation for economic loss and loss of income.

These compensation funds when converted into another form such as property still retain the protected status.

However, when these funds become intermingled with borrowed money secured by mortgage to purchase an asset such as a farm, these funds do not retain the “protected” status in relation to any claim from the mortgagee but still retain the protection status from all other creditors.

3. Does this apply to all sectors of borrowing and farming?

These rules apply to all sectors of borrowing and farming.

4. Can you explain how the bankruptcy law applied to personal injury money and how it is applied where banks are applying pressure without foreclosure and banks are doing something wrong?

As set out in answer 2 above, if the bank has a secured mortgage it can call upon such part of the protected funds as is necessary to satisfy the bank debt.

If however, the protected funds were not intermingled with the borrowed monies, the bank would not have any right to claim any of it e.g. if protected funds were used to purchase a separate block which remained unsecured.

If the protected funds are intermingled with other money to purchase an asset such as a farm, all creditors (apart from any mortgagee) has access only to that part of the farm calculated by percentage or fraction of contribution to the value of the farm.

5. Do banks have a duty of care? If so where is that recorded?

Banks may have a general duty of care to their customers in relation to certain legal matters. They include but are not limited to:

- not to breach the terms of contract, non-performance or negligent performance of a contract;
- negligence and misleading or deceptive conduct;
- implied duty to assess suitability of finance;
- implied duty to assess capacity to repay the loan and possible implied duty to avoid certain harm in extending credit;

There are certain laws which have been enacted which regulate or relate to banking matters, codes of conduct agreed upon by the banks, and principles of law found in common law.

6. How does the law get applied in this instance? Who is the body to oversee / hold the banks to account? How do they bring the banks into line?

Either party to a contract is entitled to institute proceedings in a court of relevant jurisdiction to make a decision relating to a dispute. The court is tasked to make a decision based on the evidence presented before it and based on precedents from earlier court decisions where similar principles may have been applied.

LAQ submits that a very small percentage of the community have the financial resources to litigate court actions against banks and seek a court's decision on an alleged breach of duty.

The Financial Ombudsman Service has limited scope to consider matters of this nature but will not consider matters if the matters have been to farm debt mediation.

Regardless of whether there has been farm debt mediation or not, many farmers are ineligible to lodge a complaint with FOS as the levels of debt are outside the FOS's jurisdictional monetary and/or compensation limits.

There has also been concern expressed in various quarters that FOS may not possess the necessary tools, expertise, or support to adequately consider matters of a complex financial or contractual nature relating to farm debt matters.

With the enactment of the Farm Business Debt Mediation Act 2017 (Qld), mortgagees must offer farm debt mediation before taking enforcement action. There are requirements under that Act for each party to negotiate in good faith. Queensland Rural and Industry Development Authority has a limited overseeing role in relation to the Act.

Under the former Queensland Farm Finance Strategy banks could not be forced to participate in the process and there was no body responsible for overseeing the process.

However, farm debt mediation may not be able to obtain a satisfactory outcome for a farmer where complex legal issues are in dispute and agreement cannot be reached. In these cases, there is currently no other venue available other than a court to determine these issues. This process is outside of the financial capacity of most farmers to fund.

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7. Under the Property law Act 1974 (Qld), what is the relationship between receivers, the bank and farmer rights

The answers below relate solely to situations where receivers are appointed privately by the mortgagee pursuant to the terms of the mortgage. This is distinct from circumstances where receivers are appointed by a court. These answers also are drafted on the basis that the mortgage document contains wording that the mortgagee appoints receivers as the agents of the mortgagor. This is the usual provision contained in bank mortgagees.

Section 92 of the Property Law Act 1974 (Qld) deems the above to be the case unless the mortgage provides otherwise. This section also provides for some rules relating to the appointment, powers, remuneration and duties of receiver.

By appointing receivers as agents of the mortgagors, mortgagees relieve themselves from the liabilities of mortgagees who enter into possession of mortgaged property and sell as mortgagee in possession. The agency between mortgagor and receiver has been described by commentators as being unusual, contrived, and artificial. It is a limited form of agency not possessing the usual principal and agent relationship.

The receiver has a duty to collect and realise the asset for the purpose of discharging the security and holding the balance sale proceeds in trust for the mortgagor. The receiver must exercise the powers and duties in good faith, not to sacrifice the mortgagor's interest recklessly and for proper purpose. There is no general law duty to obtain the true market value; this includes not having to wait for market conditions to improve but it must strive to obtain the best price that is reasonably obtainable having regard to the conditions.

a) e.g Are banks the agents that employ the receivers as they appoint them?

No. The mortgage documents usually provide that the mortgagee can appoint a receiver although there is no legal agency between mortgagee and receiver created as a result of that appointment.

b) Are the receivers the employees of the farmers since they pay receivers their costs?

No. Once the receivers are appointed by the mortgagee, they become the agents of the farmers not the employees of the farmers. All costs relating to the receivership are added to the mortgage debt and ultimately it will be the farmer's responsibility to pay these costs.

c) Are the receivers meant to be entirely independent of the banks as far as making management decisions about a property?

LAQ is not involved in, nor has had any direct knowledge of, the practical issues relating to the appointment of receivers or manner in which communications and decisions are made between bank and receiver.

LAQ considers that receivers should, in all circumstances, act independently of the bank and should make decisions based on information that the receiver has independently acquired.

However, LAQ understands that it is current practice for a receiver appointed by the mortgagee:

- to initially consult with the mortgagee to ascertain details of the secured assets and what they might intend to do during the receivership,
- keep the mortgagee updated and informed about the progress of the receivership from time to time and may communicate directly with the mortgagee, and
- if the receiver during the course of the receivership requires additional funds to carry out such functions, approach the mortgagee to provide those funds.

Mortgagee appointed receivers may also consult with the mortgagor and seek solutions to potential problems and to discuss management issues.

There is no obligation on the receiver to communicate with the mortgagor and keep them appraised about the progress of the receivership but there are obligations to report to mortgagor once the receivership is complete.

LAQ is aware of circumstances where the farmer has been unable to obtain information from receivers regarding day to day issues arising during the course of receivership and also other receiverships where the farmer has had considerable consultation with the receiver.

d) Are the receivers meant to run the property in regards to the best short term goals of the bank?

The duty of the receiver is to realise the secured asset for the purpose of discharging the debt within a reasonable time frame. There is no legal obligation to wait for markets to change providing for more favourable marketing conditions. The receiver should not be unduly influenced by any short term goals of the bank however LAQ is not in a position to comment upon what communications do actually occur.

e) Are the receivers meant to run the property in regards to the best long term goals of the bank?

The receiver should not be influenced by any long term goal of the bank. The duty of the receiver is to realise the secured asset for the purpose of discharging the debt not having regard to any long term goals of the bank. They will undertake short term management decisions based on advice from appropriately qualified persons in order to operate the business until such time as the asset can be sold.

f) Are the receivers meant to run the property in regards to the best short term goals of the farmer?

The duty of the receiver is to realise the secured asset for the purpose of discharging the debt not having regard to the best short term goals of the farmer.

g) Are the receivers meant to run the property in regards to the best long term goals of the farmer?

No. The duty of the receiver is to realise the secured assets for the purpose of discharging the debt and to hold any balance funds remaining in trust on behalf of the farmer.

h) Are there no rules about these issues and therefore it's an entirely fuzzy area of the law and it appears that where whoever argues loudest or most power wins?

There are a number of bodies who govern the professional conduct of some activities carried out by the insolvency industry. These bodies may have some limited power to investigate some matters. They are:

- ARITA (Australian Restructuring Insolvency & Turnaround Association) which is a professional body comprising many professionals with an interest in insolvency type matters and
- ASIC (Australian Financial Securities Authority) can also investigate complaints relating to bankruptcy administrations.

While these bodies may be able to take action relating to professional misconduct, this may be of scant benefit to a farmer who may have been wronged by this conduct unless the awarding compensation for this conduct can be awarded.

There is legislation passed in various state and federal jurisdictions which relate to the conduct of receivers. These include but not limited to the Property Law Act 1974 (Qld), the Corporations Act and others. There are common law cases following litigation where courts have provided guidance around manner in which receiverships should be conducted.

Once again, the difficulty in taking court actions is limited by the financial resources and capacity of mortgagor/farmers to fund expensive court actions.

8. In regards to the sections 96 of the property law Act 1974 (which is a law allowing 3 months for the farmer to find another financier if the bank demands its funds when no interest is owed) and section 84 (which allows external dispute resolution)

a) How do these two sections work together, e.g. Does section 96 apply before section 84 if both are possible?

<u>SECTION 96</u>

Section 96 does not provide for a 3 month period for the farmer to find another financier.

Section 96 of the Property Law Act 1974 (Qld) provides that where there has been default in payment of the principal sum and the term of the mortgage has expired, renewed or extended and where the mortgagee has accepted payment of interest for any period of 3 months or longer owing on the principal sum after default has been made (along with certain other conditions having been met), the mortgagee shall not be entitled to compel payment, foreclosure, enter into possession, or exercise power of possession without giving 3 months notice of intention to do so.

For these provisions to apply:

- the term of the loan must have expired, been renewed or extended and
- the mortgagor must be in default and,
- the mortgagor must have paid at least 3 months interest owing on the principal sum after the expiry of the loan, and
- the mortgagee has accepted such late payment.

If all these circumstances exist, then the mortgagee must give to the mortgagor 3 months notice of its intention to exercise the powers set out above. We believe that Section 96 rarely applies given all of the facts must exist.

SECTION 84

Section 84 does not provide for external dispute resolution. It sets out the regulations relating to how a mortgagee can exercise its power of sale.

Section 84 provides that the mortgagee may exercise its powers of sale after default has been made under the mortgage, notice requiring the default to be remedied has been served on the mortgagor and such default has continued for a period of 30 days.

Section 84 applies in all circumstances other than where section 96 may apply.

b) Can either apply at any time?

There must be default before either apply.

c) Does section 84 need to be exhausted before section 96 can be applied?

Section 84 applies in most matters unless the specific facts exist for section 96 to apply.

d) Is there another way of understanding the relationship?

Please see the explanation at answer 8 (a);

B. Senator Williams - Questions on Notice

On 2 August 2017 Senator Williams asked Denis McMahon during his evidence at the Public Hearing conducted in Roma:

> "What do you think are the three most important recommendations this committee should make to change laws, regulations and legislation to make the financial system better?"

The reply to this question is set out below.

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1. That all financial documents and information provided by the farmer (including but not limited to asset and liability position statements, cash flow projections, business plans, valuations, historical and other similar documentation provided for, or on behalf of, customers either in support of loan applications or at any time throughout the relationship and at times of review) be prepared, altered or updated by the customer and/or their representatives and not by the bank or financial institution.

Prior to the loan being approved, the bank will require an application form to be completed accompanied by an asset and liability position statement, cash flow projections, business plan, historical and other submissions in support of the application. Each bank has its own format for these documents. Cash flow projections provide details of the anticipated financial performance of the business and its funding requirements into the future while the submission often contains detailed history of the business and a business plan for its future needs.

Sometimes these documents are completed by a finance broker or banker in conjunction with the customer. Cash flow projections and other supporting material can often be prepared by the farmers or their agents such as accountants, rural financial counsellors, and the like. In these circumstances, the customers have control over the accuracy of the information being presented to the bank. Each party can rely upon the accuracy of the information being processed by the credit section within the bank. On balance, most credit applications are managed with due diligence and care and are not the source of dispute between banks and farmers but there are always exceptions.

FRLS has observed that disputes can arise when the bank prepares the documents supporting the loan application or makes alterations to them after the documents have been provided/approved/seen by the farmers. Documents such as cash flows, livestock schedules, historical backgrounds etc. have occasionally been prepared by bank staff. The customers are not aware of the contents of these documents. There have been circumstances where the farmer has later obtained copies of this material (after disputes arise or defaults have occurred). Cash flows have been found to be completely wrong, incorrectly overstate income or understate expenses and living costs and over-estimate livestock on hand, calving rates, projected cattle sales and ongoing crop returns.

In these circumstances, the information presented to the bank's internal credit section does not accurately reflect the capacity of the business to meet its financial commitments required under the facilities. In extreme cases, cash flows have no resemblance to the financial performance of the business. On at least one occasion, clear mistakes made by the bank in preparing cash flows used to accompany the loan application were not noticed by the credit section despite the mistake being so basic as to completely compromise the financial performance and production of the business.

The above recommendation would resolve this issue.

2. That a nationally consistent farm debt mediation process be adopted which includes provisions where:

a. that heads of agreement reached at a farm debt mediation conducted in one State, which considered matters relating to the farmer's default under a farm mortgage secured over a farm property in another State, is recognized by all jurisdictions, and

b. that the process provide that the mortgagee must produce all documents to the farmer before mediation relating to the loans and banking relationship including all documents required to be produced by the mortgagee/financier to either a court of law or the Financial Ombudsman Service should either of those institutions be required to consider farm debt matters.

Jurisdictional recognition as proposed in recommendation 2(a) above is contained the Farm Business Debt Mediation Act 2017 (Qld) and Farm Debt Mediation Act 2011 (Vic). Legal Aid Queensland supports this recommendation being extended to all jurisdictions.

In relation to recommendation 2(b) above banks and credit providers rely on legislation and contract law in order to enforce their rights against the mortgagor. In creating the contractual relationship with the mortgagor, the mortgagee is required to have complied with relevant laws and codes of conduct. The only way that a mortgagor can ensure that the mortgagee has acted lawfully is by having access to relevant documentation relating to the creation of the contractual relationship.

To enable parties in a mediation to negotiate in good faith, free and open disclosure of all relevant documentation by both parties is required. This ensures power imbalances between the parties are minimized and that the basis of the legal positions of each party is fully disclosed.

The contractual relationship between farmers and their credit providers is created by the contracts and letters of offers made by the credit provider to the farmer. These terms often provide that the bank can unilaterally change certain basic conditions in these contracts at its discretion during the period of the relationship. Letters of offer are then supported by mortgages and other securities provided by the farmer. The bank can review its position periodically throughout the period of the agreement. These contractual terms are complex and are of a level of commercial sophistication unfamiliar to most average borrowers, including farmers.

The terms contained in the letters of offer, the finance contracts, mortgage documents, and all other supporting material are not usually negotiable. These terms are prepared by the bank's internal legal staff and have been developed over many years; they are specifically designed for the banks by the banks and are framed in favour of the banks. Most often they are provided after the farmer has received a letter from the bank confirming that the bank has approved finance.

Banks are required by legislation to not act unconscionably or to make misrepresentations. Additionally, banking industry codes of conduct have also been developed. Courts have held that breaches of these codes are breaches of contracts by the banks.

To assist farmers to prepare for farm debt mediation, advisors must consider all aspects of the contractual relationship. This includes considering if there has been any illegal activity by either party to the mediation and providing advice accordingly. It is usually very clear if the farmer has breached the terms of the contract.

If the bank has committed any breaches, it is usually impossible for the advisors and farmers to actually determine if this has happened unless there is full and open disclosure made by the bank.

If all relevant documentation is not provided there is uncertainty, confusion, and often an inability of the farmer to adequately prepare for the mediation and accept outcomes.

Banks have all the historical information regarding the contractual relationship on file. While banks fail to disclose relevant information there is an expectation on the farmer to provide all relevant documentation to them before the mediation including asset and liability positions, cash flows, position statements etc.

The bank's file is discoverable by the farmer if a court action is commenced. Where the matter is eligible to be referred to the Financial Ombudsman Scheme, the bank is also required to furnish this material to the Financial Ombudsman Service.

Most banks as part of their settlement proposals require farmers to provide full discharges and releases forgoing any potential rights to court action the farmer may have against the bank for any actions up to the date of mediation. Also, banks will often request that the farmers agree not to resist any court action the bank might bring to and agree to judgement being entered. These terms of settlement are being made in circumstances where full disclosure of relevant bank documents is not being made by the banks.

Consideration should also be given to the fact that farmers experiencing financial stress are unable to afford court applications and banks are aware of this. Failure to provide documentation prior to mediation, that ultimately would be discoverable in a court action, diminishes the value of mediation and again places the bank in a superior bargaining position to the farmer.

The only way a farmer's advisors can ascertain whether there are legitimate claims against the bank is by perusing all documentation relating to the contractual relationship including material that the bank has in its possession.

Under the Code of Banking Practice[1] all participating banks and credit providers have agreed not to provide credit unless in forming their opinion about the farmer's ability to repay they have:

- exercised the care and skill of a diligent and prudent banker in selecting and
- applied their credit assessment methods.

The Courts have held that banks are contractually obligated to their customers to ensure this happens.

[1] Clause 27, Code of Banking Practice and Code Compliance Monitoring Committee Mandate

Full disclosure of relevant documents ensures that there can be no question that the bank or credit provider has breached their obligations under legislation and codes of conduct.

Consumer credit legislation has been amended to increase the level of protection for consumers, regardless of the level of sophistication of the consumer. However, there has been no equivalent level of protection for small business owners, including farmers. The Farm Business Debt Mediation Act 2017 (Qld) provides that that the mortgage must provide, if requested,

a. the farmer's application for the farm business debt and farm mortgage, and any variation of the debt or mortgage; and
b. the contractual relationship between the farmer and the mortgagee, including any loan or mortgage documents; and
c. correspondence between the farmer and the mortgagee about changes to the farm business debt or the farm mortgage; and
d. the farmer's default under the farm mortgage and any action taken by the mortgagee in relation to the default; and
e. (any other matter prescribed by regulation

The Act does not compel the mortgagee to provide the asset and liability position statements, cash flow projections, business plans, valuations, historical and other similar documentation relied upon by the mortgagee when assessing and reviewing loan applications or to provide documentation establishing how the loans were assessed and reviewed.

In relation to the provision of documents, the *National Consumer Credit Protection Act 2009* provides that banks must provide assessments if requested. The Act also deals with the provision of copies of contracts.

The provision of the above documentation in farm debt mediation would increase the level of disclosure made by banks with its customers when entering into farm debt mediation. The provision of this information would not only enable scrutiny of bank conduct but, if the bank has complied with its obligations under the law, the provision of doucments can assist the farmer to accept the reality of their position and understand that the bank may not have contributed to the default or their unfortunate financial position.

The provision of this material can have the effect of ensuring that the farmer fully understands the position the bank is taking and to work with the bank to achieve the best outcome for both parties.

3. Where a dispute arises between a bank or other financial institution which cannot be resolved by negotiation or at farm debt mediation, that either party is able to refer the matter to a free independent authority which is appropriately resourced having appropriately trained staff possessing relevant experience and expertise to hear such disputes. The result can be binding on both parties thereby avoiding expensive and lengthy legal battles within the court system.

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Throughout the various submissions made to this and other State and Commonwealth Inquiries regarding the financial needs of primary producers, Legal Aid Queensland has consistently referred to the fact that farm debt mediation may not be able to obtain a satisfactory outcome for a farmer where complex legal issues are in dispute and agreement cannot be reached. In these cases, there is currently no other venue available other than a court to determine these issues. Court litgation is outside of the financial capacity of most farmers to fund.

The above recommendation would resolve this issue.

Yours sincerely

LEGAL AID QUEENSLAND

Per:.....

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