



Victorian
Farmers
Federation

Submission to

Insolvency Practices Inquiry

January 2020

EXECUTIVE SUMMARY

The Victorian Farmers Federation (VFF) is Victorian farmer's peak industry body.

Victorian farmers have little countervailing market power and are, therefore, highly sensitive to insolvencies of those businesses to which they sell. In a worst case a grain farmer may sell all his annual production at harvest time to a trader who may quickly become insolvent, putting his whole annual income at risk.

VFF supports:

- additional measures, such as training and education, which reduce the number of insolvencies;
- introduction of reporting mechanisms resulting in earlier identification and advice to creditors of potential business problems;
- additional protections for farmer unsecured creditors

INTRODUCTION

The Victorian Farmers Federation (VFF) is one of the largest state farmer organisations in Australia, representing more than 10,000 members who live and work on more than 6,000 farm businesses situated across Victoria. The VFF Grains Commodity Group, through its elected Council, has the responsibility and autonomy to determine VFF policy regarding grains industry issues.

VFF welcomes the Insolvency Practices Inquiry and the opportunity to contribute farmer experiences as unsecured creditors in many grain trader failures.

Recent insolvencies in the grains industry, especially in Victoria, have cost the state industry approximately \$100 million. The VFF consider this initial net cost and the associated inefficiencies, not taking into consideration multiplier effects:

- Direct Financial Cost to Economy – the cost to farmers, transport companies, grain traders, and finance providers etc. is quantified as up to \$100m in net returns.
- Multiplier Effect – the multiplier effect of the original net loss is significant. If \$100 million is not flowing into rural and regional economies in Victoria, this will result in further losses for regional communities and businesses that are larger than the original loss in revenue. For example, a simple multiplier of 2.5 suggests an impact of \$250 million on the Victorian economy over roughly 18 months. Regardless of the multiplier used, the impact is clearly significant.
- Economic Recovery – the cost of economic recovery is in addition to the multiplier loss of revenue. It has been estimated that a farm business losing net dollar revenue will take approximately 5 years of gross farm production to recover the initial net loss. In other words, an annual insolvency event in the Victorian agriculture industry can take the affected farmers 5 years of production to recover the initial loss.
- Emotional and Health Impacts – the emotional and physical stress placed on business people and their families such as farmers, transport operators, and grain traders cannot be quantified, nor should it or the associated health costs be underestimated.
- Undermining Market Confidence – insolvencies impact the whole market, undermining market confidence, market liquidity, and market efficiency.
- Impact on Competition – undermined confidence can lead to reduced competition as growers 'flock' to the major grain trading houses, and can also result in higher risk premiums being charged by financiers and insurers.

In short, grain trade insolvencies have a detrimental effect across the market, industry, and broader regional community as a whole.

Such market failures demonstrate a very real need to increase the level of professionalism and accountability in the grain trade, which can only be achieved through the assistance of government to implement regulatory reform.

Victorian farmers have little in the way of consumer and business protections or support, yet they are shouldering an unfair proportion of not only the supply chain costs, but a disproportionate level of the risks incurred by the industry as a whole.

The Personal Property Securities Act 2009 (PPSA), in theory, allows sellers of goods the ability to retain title to the product and the proceeds of sale of goods pending payment by registering a Purchase Money Security Interest (PMSI). In the case of insolvency a properly registered PMSI has a superior priority to most other security interests, in effect making the PMSI holder a secured creditor with priority over unsecured creditors.

However, the PMSI has a number of shortcomings, especially in the grains industry:

- In a number of instances grain trade contracts do not enable growers to retain title – therefore voiding the PMSI.
- While on face-value a PMSI is arguably relatively easy to register online, it is understood that in reality even minor coding ‘errors’ will render a PMSI invalid, yet the online system does not advise the registrant that the PMSI has been incorrectly lodged.
- Assuming a PMSI has been correctly lodged, and is valid with retention of title, it appears that in the case where physical grain has been out-turned to a third party the grower does not retain a claim over the stock or payment for the grain, but simply becomes a secured creditor and must stand in line with other secured creditors, such as banks, to try and recover funds from any remaining assets of the company.

The PMSI is not a preventative measure to trade insolvencies. In the case of insolvency it may increase a grower’s status from unsecured to secured creditor, but does not prevent the insolvency event from occurring in the first place and is no guarantee of payment for grain or recovery of funds.

Standards need to be introduced to provide a more equitable balance for farmers, who incur not only production risk, market risk, price risk, and costs, but are also bearing the capital risk of their counterparty’s businesses.

QUESTIONS AND ANSWERS

1. At the initial consultation with a registered liquidator, should the registered liquidator be required to provide a small business with:
 - a. A hard copy plain language fact sheet that outlines the various types of external administration and the role of directors and owners in each?

It has been VFF's experience that many parties do not fully understand the process of liquidation. Simple language which facilitates greater understanding of the processes and each party's role is strongly supported.

- b. The reasons for recommending a particular course of action to the directors?

As with question 1.a above VFF fully supports greater transparency and explanation of actions taken by all parties to an insolvency event.

2. Should there be a control mechanism to prevent the total costs of an external administration from consuming the value of the company's assets? What form could this take?

VFF's experience is that costs of an external administrator or liquidator are excessive, not well understood or transparent and that there appears to be a lack of accountability/control of costs incurred by the external administrator.

The example of a remuneration claim detailed in the Discussion Paper highlights excessive hourly rates. These must be capped at more reasonable levels, perhaps through regulation.

A cap on total costs is supported provided it is through a readily understood mechanism such as a fixed price or capped quote structured to allow the registered liquidator time to assess the financial position of the business quickly then assess and recommend further action.

Any further action required would then be subject to creditors' prior approval of a quote.

3. Should an information sheet of the average costs for a 'day in court' and the average numbers of court days for particular actions be included with each creditors report?

VFF supports any increase and clarity in information relating to potential costs.

4. In consideration of technology available today, how beneficial would it be to automatically provide the *Annual Administration Return* report lodged with ASIC to creditors, directors, owners?

Again, in the interests of transparency all relevant parties should receive a copy of the Annual Administration Return report.

5. Should valuations be provided to, and proposed marketing strategies require approval from, creditors?

As the sale of a business impacts the returns to all creditors, valuation reports and marketing strategies should require creditors' approval.

6. Should demands to recover payments determined to give a creditor an unfair preference in a winding up require the registered liquidator to include the evidence they relied on in making that determination?

In the interests of transparency and to mitigate potential disputes and legal action, evidence supporting the recovery of preferential payments should accompany such requests.

Clarity is required as to what constitutes an unfair preferential payment. If payment to a non-related party is made in the normal course of business within 6 months of an insolvency event it should not be recoverable by the liquidator.

Further, VFF supports recovery of preferential related party payments, such as owners/directors and companies with common shareholdings, over the preceding 12 months.

VFF notes that phoenixing directors and/or companies are a problem which requires further attention by Government. It appears too easy, and happens too frequently, for a business to become insolvent only for the owners/directors to quickly start an identical, if not extremely similar, business (and business name) leaving creditors to deal with the insolvent company while they continue to trade. In these circumstance owners/directors must be made more accountable.

7. Should it be mandatory for individuals seeking to be directors of companies to undertake core education on running a business and the potential risks of personal exposure to liabilities before being eligible for appointment?

VFF fully supports education for owners/directors to enhance their ability to manage a business. However, such education should not be mandatory but recommended by industry.

Industry, including grain producers and trade organisations, such as the Grain Industry Association of Victorian (GIAV) and Grain Trade Australia (GTA), could be engaged in developing appropriate industry training and qualifications. We note that GTA have developed an Australian Grain Industry Code of Practice which is mandatory for GTA membership. This includes the following statements in regards to financial management:

2.7.6 Financial Management

Industry participants employ financial management processes:

- To ensure that there are adequate resources to meet their objectives;
- To remain solvent;
- To ensure continual operation within the grains industry;
- To ensure they are sustainable, properly capitalised and funded; and
- To ensure they have adequate cash flow to support their operations and to contribute to achieving their goals. Sound financial management is undertaken.

At all times industry complies with relevant financial legislation (e.g. Financial Services Reform Act) including any requirement for:

- Record keeping;
- Financial reporting;
- Auditing; and
- Those companies offering financial advice must operate under an Australian Financial Services License.

Companies have a documented procedure relating to financial management.

It should be stated however that independence and enforceability are seen by producers as key criteria to an effective system. As non-binding voluntary codes of conduct are considered ineffectual in delivering any genuine industry change or accountability enforceable regulatory change is required.

8. Should it be mandatory for individuals seeking to start a company or register an ABN to undertake core education on running a business and the potential risks of personal exposure to liabilities?

See answer to question 7 above.

9. Where a small business seeks advice when facing financial difficulties, should the individual proposing a course of action be required to provide the small business with:
- a. A hard copy plain language fact sheet that outlines the various types of external administration available and the role of directors and owners in each?

As with the answer to question 1.a above, VFF supports greater education, transparency and the provision of relevant advice and explanations in simple language.

- b. The reasons for recommending a particular course of action to the directors?

As with question 9.a above VFF supports greater transparency and explanation of actions taken by all parties to an insolvency event.

10. How can the safe harbour provision be improved to encourage small business to take action early and gain time to assess the viability of the business?

VFF supports any action which enables businesses to successfully trade out of difficulties, resulting in a greater return to creditors.

11. How can accountants and bookkeepers best support small businesses to seek help early?

VFF supports any action which enables a business to identify problems early, take action and better protect the business, owners and creditors.

Experience in dealing with multiple grain trader failures shows VFF that earlier detection may result in fewer farmers becoming unsecured creditors to grain traders.

12. Should increased funding and resources be provided to the financial counselling sector to enable them to provide services to small businesses experiencing financial difficulty?

Grain farmers sell a significant, if not the majority, of their annual harvest at harvest time. Should a purchaser fail after taking delivery of the grain but prior to paying the farmers, the farmers become an unsecured creditor with theirs and their families' livelihood at risk. This leads to significant financial and personal stress. Any increase in funding and resources to rural counsellors would greatly assist.

13. Should the impact on the mental health of small business owners and directors be cause for a pause in proceedings?

VFF recognises that mental health is a serious issue for farmers and small business owners. The National Centre for Farmer Health and Aussie Farmers Foundation are two organisations established to deal with mental health issues for farmers.

Business owner mental health must be considered during insolvency as should the mental health of creditors who are themselves likely to be small businesses or individuals. As previously mentioned a substantial portion of a farmer's annual income may be tied up in business insolvency as an unsecured creditor, potentially leading to enormous financial and personal stress. It is, therefore, important that any business insolvency where farmers are creditors be handled carefully and quickly. While a pause in proceedings may be beneficial to the mental health of business owners, the longer farmer creditors have to wait for funds could give rise to lead to increasing farmer financial stress and mental health issues.

14. Are there other changes that could assist the parties where there are mental health issues?

No further information.

15. General submissions are sought on the fairness of having one system and the benefits and risks of implementing different processes so the costs and time to complete an external administration achieves the optimum outcome for creditors, employees and company.

As previously stated due to the nature of farm production systems and how production is marketed, especially grain production and marketing, a significant portion of a farmer's annual income may be tied up in insolvency. In such circumstances it is important different processes are implemented to protect the on-going business of the farmer unsecured creditors.

VFF recommends further proactive regulatory measures be taken to reduce potential insolvencies thereby protecting farmer unsecured creditors.

The Victorian Farmers Federation

Victoria's agricultural production accounts for over \$13 billion of Victoria's economy and over 25 per cent of the State's exports per annum. Victoria's farmers produce high quality food and fibre, produced to high standards of safety, with little taxpayer support, and to some of the strictest environmental and highest animal welfare controls in the world.

The Victorian Farmers Federation (VFF) represents a farming community which creates a profitable, sustainable and socially responsible agriculture sector connecting with consumers. We have a proud history representing Victoria's farm businesses since 1979 – primarily family farms that produce the eggs, grain, fruit and vegetables, meat, and milk that help to feed Victoria's six million people, and the bigger global community, every day.

The VFF consists of commodity groups: dairy (United Dairyfarmers of Victoria), grains, horticulture (including Flowers Victoria), intensives (chicken meat, eggs and pigs), and livestock – and expert committees representing; water, land management, agricultural and veterinarian chemicals, farm business and rural development, and workplace relations.

Our purpose is to make Victorian farmer's lives better; enhancing Victoria's future.

Our mission is to ensure a community of farmers creating a profitable, sustainable and socially responsible agricultural industry connecting with all Victorians.



Our place in Victoria

What we do



- Victoria's **20,775 farms** cover **10.6 million hectares**
- We are **24.2%** of Australian farmers
- **91%** family operated, with only **2%** foreign owned



- We employ **87,800** people mostly in regional areas
- **\$4739** of food consumed each year by every Australian
- As a net exporter we have long term food surity



- Our annual production is **\$13.16 billion**, **3.5%** of Victoria's economy
- **27.8%** of Victoria's exports are agricultural product valued at **\$11.9 billion**

How we do it



- Farmers invest **\$80 million** in R&D
- Every R&D **\$1** converts to **\$12** in farmer generated impact
- **2.7%** productivity growth through innovative efficiency gains
- Farmers receive less than **1.5%** in government support



- **63%** reduction in greenhouse gas emissions between 1996-2016
- Water consumption reduced by **7%** from 2014-2015
- Land conservation has increased to **18%** of total land mass.
- Farmers spend **\$20,000** annually on feral animals and pest weeds



- **3.5 million** beef cattle
- **140 million** chickens
- **1.1 million** dairy cows producing **6.186 billion** litres of milk
- **65,992** sows
- **13.1 million** breeding ewes and a fleece clip of **66,100 tonnes**
- **6.5 million** tonnes of grain
- **\$2.35 billion** in horticultural production