

# North Dakota's Agricultural Mediation Service

James F. Baltezare, Cole R. Gustafson, and F. Larry Leistriz

The United States Congress enacted the **Agricultural Credit Act of 1987** (P.L. 100-233, 1988) to solve some of the financial problems facing farm borrowers and lenders. The act restructured financial institutions providing credit to farmers, set conditions under which delinquent farm loans are restructured or foreclosed, and provided delinquent borrowers with numerous borrower rights. One provision of the act established federal funding for development and operation of state-sponsored agricultural mediation programs. The intent of mediation programs was to furnish a mechanism whereby agricultural borrowers and lenders could resolve their financial problems with minimal litigation costs.

## INFORMAL MEDIATION

Prior to the **Agricultural Credit Act of 1987**, "informal mediation" was used to resolve farm borrower/lender disputes. Farmers would contact the North Dakota Department of Agriculture requesting assistance with their financial problems. The department would assign credit counselors who would help farmers develop financial plans to meet debt obligations. If necessary, credit counselors would bring borrowers and lenders together to resolve financial disputes. Lenders including Farmers Home Administration (FmHA) and Farm Credit Services (FCS) were not required by law to participate and could foreclose on borrowers once loans became delinquent. Only state appropriated funds were available to support the effort of credit counselors.

## FORMAL MEDIATION

"Formal mediation" was created with passage of the **Agricultural Act of 1987**. Either a farm borrower or a creditor of a delinquent farm borrower could request mediation. FmHA and FCS borrowers must be offered mediation and given time to complete the mediation process before these creditors could initiate foreclosure proceedings. Participation by other creditors is strictly voluntary.

The Agricultural Mediation Service provides farmers with a negotiator (duties similar to credit counselors) once a farmer or lender requests mediation. Negotiators help farm operators prepare financial documents necessary to participate in the mediation process. Negotiators attend mediation sessions with the borrower and are required by law to negotiate on their behalf. Many negotiators (and mediators) hired by the mediation service are part-time or retired farmers.

---

*Baltezare is research assistant, Gustafson is assistant professor, and Leistriz is professor, Department of Agricultural Economics.*

The mediation service assigns a mediator to each case. The mediator arranges meetings between farm borrowers and their lenders. Borrowers and lenders attempt to resolve their financial differences at the meeting with the mediator acting as a moderator and facilitator.

Participants either reach an agreement or "agree to disagree." Creditors (FmHA and FCS) can initiate foreclosure proceedings only after mediation reaches an impasse. The mediation program gives farmers and lenders an opportunity to negotiate a mutually acceptable resolution of the borrower's debt delinquency. Mediation can yield similar results as bankruptcy while minimizing legal fees and court costs of both lender and borrower.

## NORTH DAKOTA'S MEDIATION SERVICE

North Dakota established a mediation service in January 1989. (As of January 1, 1990, 16 states had active mediation programs.) Mediation services are administered by the Agricultural Mediation Service under the direction of the North Dakota Department of Agriculture, Bismarck. The first mediation sessions were held in March 1989. The mediation service is responsible for training negotiators/credit counselors and mediators, accepting applications for mediation, and arranging meetings between farm borrowers and lenders. The program is voluntary for borrowers, and nominal fees are charged to participants. A waiver can be granted to those unable to pay.

Over 1,385 requests for mediation were initiated during 1989. As of December 31, 1989, 212 cases still were open. Of the 1,174 mediation cases resolved in 1989, 605 farmers were offered mediation and either declined or did not respond and lost the right to mediate. Of the remaining 569 cases which went to mediation, 65 percent ended with some type of agreement between borrower and lender.

## MEDIATION BENEFITS

Mediation benefits both farm borrowers and creditors. The major benefit is the potential to resolve borrower/creditor disputes as an alternative to foreclosure or bankruptcy, thus avoiding associated monetary costs, time demands, and uncertainty (Gustafson et al., 1987). Costs associated with Chapter 12 bankruptcy were an estimated \$9,900 for attorney's fees and expenses and \$3,400 for trustee's fees (Faiferlick and Harl, 1988). Time required to complete bankruptcy was nearly four times longer, and more expensive, than settlements negotiated outside of bankruptcy. Additional out-of-pocket expenses for borrowers and creditors

included court, bookkeeping, and accounting costs. Other potential borrower and creditor benefits are a quicker, more private settlement and an overall more favorable settlement than bankruptcy or foreclosure.

### Borrower Benefits

Farm borrowers could use mediation to delay appeal or foreclosure proceedings. Delays might allow the borrower more time to identify and evaluate legal, business, and personal alternatives and for economic conditions in North Dakota to improve. An additional step before foreclosure might extend the time involved in the overall settlement process, adding to creditors' costs and potentially making them more willing to negotiate and make concessions.

Mediation might allow the borrower to remain on the farm. Mediation agreements could involve restructuring loan payments and/or modifying the farm operation. Modifications might include selling some assets or changing enterprise combinations to create a feasible farm plan. Restructuring loans and/or modifying the farming operation could produce a farm plan that would allow the borrower to pay bills and to continue farming.

### Creditor Benefits

Creditors face economic costs because of delinquent or nonperforming loans (Gustafson et al., 1987). Economic costs include uncollected principle and interest, maintenance costs (insurance, property taxes, and repairs), and losses on the sale of collateral property. Creditors encounter financial uncertainty from changes in collateral values from the time of default until the obligation becomes current or collateral is acquired.

Mediation presents an opportunity for creditors to turn delinquent loans into performing loans, thus reducing their economic costs. Credit institutions may forgive principal and interest payments in arrears, lower loan interest rates, and extend the loan duration to establish a performing loan. The average debt write down (debt forgiven to restructure loans) per FmHA borrower through November 1989 was \$146,000 (Taylor, 1990). The average debt write off (debt forgiven in loan buyouts or liquidations) during the same period was \$204,800 per FmHA borrower. The creditor may have a financial incentive to participate in mediation to write down delinquent loans. By shortening delinquency periods and using write downs rather than write offs, overall losses to credit institutions may be less with mediated agreements than with bankruptcy.

Creditors may want to avoid legal uncertainties associated with bankruptcy proceedings. Mediation provides creditors an ample chance to participate in negotiations and influence mediation settlements. The ability of creditors to affect settlements may be lost during bankruptcy.

## EVALUATION OF NORTH DAKOTA'S MEDIATION SERVICE

The Department of Agricultural Economics with the cooperation of the North Dakota State Department of Agriculture conducted a survey of both farm borrowers and lenders to evaluate mediation service delivery as administered by the North Dakota Agricultural Mediation Service. The survey was designed to identify expectations of borrowers and creditors before mediation, discover motives for trying mediation, estimate mediation costs, evaluate mediation as a means of resolving farm borrower/creditor problems,

and identify potential improvements to the mediation service (Baltezare et al., 1990).

A mail survey was used to collect data from borrowers and creditors who participated in mediation during 1989. Although separate survey instruments were developed, major sections of the creditor questionnaire were similar to the farm borrower questionnaire so responses could be compared. The sample consisted of 480 farm operators who used the mediation service and nearly 360 financial institutions (Table 1).

Over 430 questionnaires were returned after two mailings --249 creditors and 183 farm borrowers. Response rates were 69 percent and 38 percent of the creditor and borrower surveys, respectively. The overall response rate was 52 percent.

### Expectations

Half the farm borrowers and 65 percent of the creditors responding described their relationship as *friendly* or *very friendly* before mediation. Twenty percent of the borrowers and 2 percent of the creditors indicated their relationship was *hostile* or *very hostile*. Over 30 percent of the borrowers expected the creditors to be *inflexible* before mediation, while less than 20 percent of the creditors expected the borrowers to be *inflexible*. Nearly 30 percent of the borrowers and less than 10 percent of the creditors felt *fearful* or *extremely fearful* about participating in mediation before attending the first mediation session. Borrowers were significantly more fearful of mediation than were creditors. Less than a third of both borrowers and creditors had *little* or *no understanding* of the mediation process before the first mediation session.

**Table 1. Survey groups and sample sizes, North Dakota agricultural mediation service survey, 1990.**

Survey Group	Sample Size	Percent of Survey Group
<b>Creditors</b>		
Farmer Home Administration (county and district offices)	54	15.1
Farm Credit Services (branch and regional associations)	32	8.9
Credit Unions	115	32.0
State and national banks	158	44.0
<b>Total</b>	<b>359</b>	<b>100.0</b>
<b>Borrowers</b>		
Farmers Home Administration		
Reached an agreement	273	56.8
No agreement	134	27.8
Farm Credit Services		
Reached an agreement	45	9.6
No agreement	28	5.8
<b>Total</b>	<b>480</b>	<b>100.0</b>
<b>Totals</b>	<b>839</b>	

## Motives

The possibility of a quicker settlement compared to bankruptcy or foreclosure was the primary motive for borrower participation in mediation based on a weighted average of responses (Table 2). Secondary borrower motives were a more private means of settlement than bankruptcy and their negotiator recommended mediation participation. Borrowers did not appear to be using mediation as a stall tactic.

The primary reason creditors participated in mediation was the borrower wanted mediation. Compliance with federal mandates was the dominant reason why creditors participated. Creditors participated to a lesser extent in hopes of a quicker settlement and because mediation provided a more private means of settlement than bankruptcy.

Neither borrowers nor creditors participated in mediation to lower their legal costs. One of the reasons for developing a mediation service was to minimize out-of-pocket costs of both sides. Borrowers and creditors seemed unaware of this benefit or were less concerned with minimizing their costs.

**Table 2. Borrower and creditor motives for trying mediation ranked by a weighted average of responses, North Dakota agricultural mediation survey, 1990.**

Motives	Borrowers		Creditors	
	Weighted Average	Rank	Weighted Average	Rank
Provide a quicker settlement	381	1	309	2
More private settlement than bankruptcy	358	2	308	3
Negotiator recommended it	358	3		
Hoped to cut a better deal with mediation	340	4	233	5
Borrower/creditor suggested mediation	334	5	382	1
Wanted to delay foreclosure	323	6		
Lower legal costs	315	7	256	4

## Mediation Settlements and Costs

Over 50 percent of the borrowers and 70 percent of the creditors indicated some type of agreement was reached through mediation. The mediation program provided by the North Dakota Mediation Service appears to be an effective mechanism to resolve financial difficulties among farm borrowers and their creditors based on the percentage of settlements reached. Over 55 percent of the borrowers and nearly 40 percent of the creditors responding rated settlements reached through mediation as *favorable* compared to bankruptcy.

The average cost of participating in mediation was \$385 per borrower. This includes lawyer and financial adviser fees and travel expenses. Borrower costs ranged from a low of \$0 to a high of \$13,000. The average cost of creditors participating in mediation was \$100 per institution and ranged from \$0 to \$2,000.

Mediation cost the average farm borrower significantly more to participate in than the average creditor. Lower

mediation costs for creditors may be due to their ability to spread costs over more cases and internalize some of the costs of participating in mediation. Over 55 percent of the borrowers and nearly 40 percent of the creditors responding rated the cost of mediation as *much less* than the cost of bankruptcy.

## Mediation Process

The negotiator assisted/advised the majority of responding borrowers engaged in mediation. Nearly 20 percent of the borrowers sought additional advice from lawyers. Another 5 percent hired private consultants.

Sixty percent of the borrowers and 70 percent of the creditors rated the speed of the mediation process as *faster* than bankruptcy proceedings. Over 60 percent of the borrowers rated mediation a *good* or *very good* way of solving borrower-creditor problems in general. Less than 30 percent of the creditors responding thought mediation was a *good* way to solve borrower-creditor problems. However, 50 percent of the creditors rated mediation as *okay*. When asked to rate mediation as a way of solving their financial problems, nearly 60 percent of the borrowers and less than 20 percent of the creditors responded *good* or *very good*. Over 45 percent of the creditors rated mediation as an *okay* way of solving their financial problems with delinquent borrowers. Nearly 60 percent of the borrowers and 40 percent of the creditors thought the mediation procedure was *fair*.

## Mediators

Borrowers and creditors responding gave favorable evaluations of mediators assigned to their cases. Borrower evaluation of mediators were significantly higher than creditor evaluations. Nearly 70 percent of the borrower and 40 percent of the creditors responding rated the mediator as *good* or *very good* for each of the evaluation questions. Specific mediator attributes borrowers and creditors rated most favorable based on a weighted average of responses were patience, truthworthiness, explanation of the mediation process, ability to listen, and knowledge of farm finance (Table 3). Attributes on which borrowers and creditors rated

**Table 3. Borrower and creditor mediator evaluations ranked by a weighted average of responses, North Dakota agricultural mediation survey, 1990.**

Attributes	Borrowers		Creditors	
	Weighted Average	Rank	Weighted Average	Rank
Patience	409	1	370	1
Trustworthiness	403	2	362	3
Explanation of the mediation process	402	3	358	5
Ability to listen	402	4	365	2
Knowledge of farm finance	398	5	335	10
Competence	394	6	341	8
Knowledge of farming	394	7	359	4
Communication skills	393	8	341	7
Neutrality	392	9	350	6
Ability to establish priorities	389	10	320	11
Understanding of the issues	389	11	336	9
Ability to advise	381	12	317	12
Ability to overcome obstacles	372	13	313	14
Suggestions	368	14	315	13