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**Mediation of Ag Credit Disputes:  
Experiences in North Dakota**

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**Abstract**

This study presents an evaluation of the North Dakota Agricultural Mediation Service from borrower and creditor perspectives. Data were gathered using a mail survey of borrower and creditor mediation participants. Farm borrowers in particular, and creditors in general, furnished favorable evaluations of the mediation process and the mediation service.

**Keywords:** Mediation, survey, farmers, creditors, borrowers, farm finance, costs, evaluation, motives, North Dakota.

**AGRICULTURAL CREDIT MEDIATION:  
BORROWER AND CREDITOR PERSPECTIVES IN NORTH DAKOTA**

The 1980s were a time of extreme financial stress for farm borrowers and their creditors. Volatile monetary and fiscal policies created farm financial conditions similar to those in the 1930s (Murdock and Leistritz) with farm bankruptcies and foreclosures occurring at a rate seven times greater than the historic average (U.S. Department of Agriculture). The United States Congress passed the Agricultural Credit Act of 1987 (P.L. 100-233, 1988) in an effort to relieve financial problems facing farm borrowers and creditors.

The Act restructures financial institutions which provide credit to farmers, sets forth the conditions under which delinquent farm loans are either restructured or foreclosed upon, and provides delinquent borrowers with numerous borrower rights. Title V of the Act established federal funding for development and operation of state-sponsored agricultural mediation programs to furnish a formal mechanism whereby agricultural borrowers and creditors could resolve their financial difficulties while minimizing legal expenses. As of January 1, 1990, 16 states had active mediation programs.

This article describes the North Dakota Agricultural Mediation Service and identifies potential benefits of mediation as a means of resolving financial difficulties among farm borrowers and creditors. Results of a survey of farm borrowers and creditors who participated in mediation are also presented. The survey estimates expectations of borrowers and creditors prior to mediation, identifies motives of each party trying mediation, and evaluates mediation as a means of resolving farm borrower/creditor problems. Finally, suggestions for improvement in the mediation service are also discussed.

**North Dakota Agricultural Mediation Service**

North Dakota established a state mediation service in January 1989 and held its first hearings in March 1989. Over 1,385 requests for mediation were initiated

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during 1989. Credit institutions initiated nearly all the mediation requests. As of December 31, 1989, 212 cases (15 percent) were still unsettled. Of the 1,174 mediation cases resolved during 1989, 605 farm operators were offered or requested mediation and either declined mediation or did not respond to mediation requests and therefore lost the right to mediate. The remaining 569 cases went to mediation.

Mediation is strictly voluntary for farm borrowers. However, creditors, namely Farmers Home Administration (FHA) and Farm Credit Service (FCS), must participate in mediation if a mediation hearing is requested by one of their delinquent farm borrowers. Either a farm borrower or a creditor of a delinquent farm borrower can ask for mediation. Mediation must be offered before foreclosure can be initiated and only after mediation reaches an impasse can foreclosure proceedings begin.

The mediation service provides farm borrowers with a credit counselor/negotiator once mediation is requested. Credit counselors/negotiators prepare borrowers for mediation. A mediator is also assigned to each case. The mediator acts as a facilitator bring the borrower and lender together to resolve their financial differences.

#### Mediation Process and Benefits

financial disputes (Kochan et al.). The effectiveness of mediation can be judged by the number of settlements reached. Alternative, mediation can be described as a narrowing process. Participants start with a number of differences and resolve each one by one until none remain and a total agreement is reached. Therefore, mediation success can be evaluated by the number of individual issues resolved. Individual issues involved in agricultural mediation include estimation of future cashflows, forgiving principle and interest payments, lowering interest rates, and extending loan duration.

Mediation has potential benefits for both farm borrowers and creditors. The major benefit of mediation is the opportunity to resolve borrower/creditor disputes before bankruptcy thus avoiding associated monetary costs, time demands, and uncertainty (Gustafson et al.). Faiferlick and Harl estimated costs for borrowers involved in Chapter 12 bankruptcy to be \$9,900 for attorney's fees and expenses and \$3,400 for trustee's fees. The time required to complete bankruptcy proceedings was nearly four times longer (and more expensive) than settlements negotiated outside of bankruptcy. Additional out-of-pocket expenses for borrowers and creditors were court costs and bookkeeping and accounting costs. Other possible benefits of mediation include reduced legal costs, a quicker settlement, a more private settlement, and an overall more favorable settlement when compared to bankruptcy.

Farm borrowers could use mediation as a means of delaying foreclosure proceedings. Delays might allow borrowers more time to identify and evaluate legal, business, and personal alternatives. Delays might also allow more time for economic conditions in North Dakota to improve, especially after two consecutive years of drought. An additional step before foreclosure might extend the time involved in the overall settlement process adding to creditor costs and potentially making them more willing to negotiate and make concessions.

Creditors face considerable economic costs as a result of delinquent or non-performing loans (Gustafson et al.). Economic costs incurred include uncollected principle and interest, maintenance costs (insurance, property taxes, and repairs), and losses on the sale of collateral property. Creditors also face further financial uncertainty brought about by changes in collateral values from the time of default until the obligation becomes current or collateral is acquired. Mediation is a means creditors have of turning some delinquent loans into performing loans thus reducing economic costs associated with delinquency.

Credit institutions may be willing to write down principle and interest payments in arrears, lower loan interest rates, and extend the loan duration in an attempt to establish a performing loan. The average loan write down (debt forgiven to restructure loans) per FHA borrower through November 1989 was \$146,000 (Taylor). The average debt write off (debt forgiven in loan buyouts and liquidations) during the same time period was \$204,800 per FHA borrower. This suggests that there may be a financial incentive for creditors to participate in mediation in an attempt to write down rather than write off delinquent loans. By shortening delinquency periods and using write downs, overall losses to credit institutions may be less with mediated settlements when compared to bankruptcy.

Creditors may also want to avoid legal uncertainties associated with bankruptcy. Mediation provides creditors with an ample chance to participate in negotiations. The opportunity creditors have to influence and affect decisions may be lost in bankruptcy proceedings.

#### Survey Procedure

Data used to evaluate North Dakota's Agricultural Mediation Service were collected from mail surveys of both farm borrowers and creditors. Although separate survey instruments were developed, major sections of the creditor questionnaire were similar to the farm borrower questionnaire so that responses could be compared. Farm borrower and creditor responses were compared to identify differences in motives, expectations, and perceptions of the mediation process. Significant differences in opinions may indicate areas where the mediation process could be modified to improve program content and delivery.

The borrower sample consisted of nearly 480 farm operators who used the mediation service. Borrowers surveyed had mediated either with FHA or FCS. Over 80 percent of the sample participated in mediation proceedings with FHA.

The borrower survey instrument was designed to elicit attitudinal responses on the mediation process and mediation in general as a way of solving borrower/lender conflicts. The survey instrument was used to identify motives for trying mediation as well as borrower expectations prior to mediation. Several sets of statements were contained in the questionnaire for which respondents could select responses from a Likert-type scale (Likert).

Nearly 360 financial institutions in the state were also surveyed. This included 54 county and district FHA offices, 32 branch and regional FCS associations, 115 credit unions, and 158 state or national banks operating in North Dakota.

A Kruskal-Wallis test (K-W) is used to identify differences in responses among surveys for questions with yes-no and Likert-type responses. K-W one-way analysis of variance by ranks is used to test whether independent samples are

from different populations (Daniel). The K-W test determines if differences among samples represent merely chance variations or genuine population differences (Seigel). Scores are converted to ranks using more of the information in the observation than just a means test. The test is useful in situations where a normality assumption does not hold or is not critical (mendenhal et al.)

### Results

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

### Expectations

Most farm borrowers (50 percent) and creditors (65 percent) responding described their relationship as friendly or very friendly before entering into mediation. Twenty percent of the farm borrowers and 2 percent of the creditors responding described their relationship as hostile or very hostile. Over 30 percent of the farm borrowers expected creditors to be inflexible before mediation, while less than 20 percent of the creditors expected the majority of their borrowers to be inflexible. Nearly 30 percent of the borrowers responding felt fearful (19 percent) or extremely fearful (11 percent) about participating in mediation prior to attending their first mediation session. Less than 10 percent of the creditors responding were either fearful or extremely fearful. Borrowers were significantly more fearful of mediation than were creditors.

The majority of borrowers and creditors did not contact other borrowers/creditors who had participated in mediation to see what their experiences were before deciding on mediation. However, creditors did contact other credit institutions significantly more often (20 percent) than borrowers (10 percent). Less than 35 percent of the borrowers and 30 percent of the creditors responding indicated they had little or no understanding of the mediation process before attending the first mediation session.

### Motives

Borrowers indicated their primary motive for mediation was an opportunity for a quicker settlement (Table 1). Over 70 percent of the respondents either agreed or strongly agreed mediation would provide a quicker settlement. Sixty percent of the borrowers responding tried mediation because mediation was a more private means of settlement than bankruptcy. Nearly 30 percent of these respondents strongly agreed that they tried mediation because it was a more private means of settlement. Borrowers did not use mediation as a stall tactic since over a third of the respondents disagreed that wanting to delay foreclosure was a motive for trying mediation.

Seventy-five percent of the creditors responding indicated that they participated in mediation because the farm operator wanted to. Nearly 50 percent of the creditors participated in mediation because it would provide a quicker settlement. However, more than 50 percent of the creditors responding disagreed that mediation would lower their legal costs and they would get a better deal through mediation.

### Mediation Settlements and Costs

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

The average cost of participating in the mediation process for farm borrowers was \$380 per borrower. (This includes lawyer and financial advisor fees and travel expenses.) Costs reported by borrowers ranged from a low of \$0 to a high of \$13,000. The average cost of participating in mediation for creditors responding was \$103 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 borrowers and nearly 40 percent of creditors responding rated the cost of mediation as much less than the cost of bankruptcy.

### Mediation Process

The majority of the borrowers surveyed were assisted/advised during the mediation process by the credit counselor/negotiator assigned to their case. Nearly 20 percent of the borrowers sought additional assistance from lawyers. Another 5 percent hired private consultants.

Sixty percent of borrowers and 70 percent of creditors rated the speed of the mediation process as faster when compared to bankruptcy proceedings. Over 60 percent of the borrowers responding 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 creditor responding rated mediation as okay.) When asked how they would 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. 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 (Table 2). Borrower evaluations of mediators were significantly higher than creditor evaluations. Nearly 70 percent of the borrowers and 40 percent of the creditors responding rated the mediator as good or very good for each evaluation questions. However, around 10 percent of the creditors rated the mediator's competence, neutrality, understanding of the issues, and overall performance as poor.

The majority of borrowers and creditors had confidence in the mediator's ability to reach a settlement. Both sides felt the mediator assigned to their case(s)

was sympathetic to their position. Nearly 95 percent of the borrowers and over 85 percent of the creditors responding indicated that their case(s) was presented fairly to all parties at the mediation session by the mediator.

#### Mediation Service Improvements

Borrowers and creditors responding offered similar suggestions to improve mediation service delivery. Specific recommendations regarding mediation sessions included requiring all creditors to be present and documenting mediation sessions and agreements reached. In some instances, agreements could not be reached because the position of creditors not attending mediation sessions was unknown. Documenting sessions was important so both sides had written testimony of what was said and agreed upon.

Recommendations to improve the overall mediation process included establishing definite time intervals, requiring legally binding agreements, and developing a mechanism for follow-ups. Respondents wanted specific time periods established for each step in the mediation process so mediation would be completed in a timely manner. Many respondents also wanted agreements to be legally binding. Some creditors and borrowers responding indicated that one side or the other failed to uphold their end of the agreement. Devising a mechanism for following up on agreements would help resolve this situation.

#### Summary

The purpose of this study was to evaluate the North Dakota Agricultural Mediation Service from both the farm borrower and creditor perspectives. An evaluation was based on a mail survey of both borrowers and creditors using the mediation service. Survey returns provided the basis for identifying participant expectations, motives, costs, and perceptions of the mediation service.

Generally, farm borrowers had a friendly relationship with the creditor involved in mediation. However, borrowers did not expect their creditor to be flexible in negotiations. Most borrowers had some understanding of the mediation process prior to the first mediation session, yet they were fearful about participating in mediation. The primary reasons borrowers participated in mediation was the hope of a quicker, more private settlement than through bankruptcy. Farm borrowers rated mediation as a good way of solving financial problems among farm borrowers and creditors and believed the mediation procedure was fair.

Creditors perceived their relationship with borrowers as friendly, but were undecided as to how flexible farm borrowers would be during the mediation process. Creditors understood the mediation process and felt relatively confident before attending the first session. The fundamental motive for creditors participating in mediation was that the farm borrower requested it. Secondary motives were a quicker, more private settlement than bankruptcy. Creditors felt mediation was a satisfactory way of solving borrower-creditor problems in general. However, creditors rated mediation as a poor way of solving their problems with farm borrowers. Most creditors believed that the mediation procedure was neither nor unfair.

Farm borrowers generally support mediation as a means of resolving their financial difficulties with creditors. Mediation offers a quick, more private, and fair means of settlement. Conversely, creditors take a less positive view



of mediation. Creditors participate primarily because it is mandated by the Agricultural Credit Act of 1987.

Mediation appears to be an effective mechanism for resolving borrower-creditor conflicts. It is supported by the majority of farm borrowers and to a less extent by creditors who have participated. Support for mediation from both sides of the issue implies that mediation is constructive in settling financial problems among farm borrowers and their creditors.

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