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## The Role of Mediation in the USDA

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# The Role of Mediation in the USDA

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### I. INTRODUCTION

The United States Department of Agriculture (USDA) Certified State Mediation Program has restored failed communications between numerous farmers and lenders and assisted many economically stressed farm families to stay in business. The Farmers Home Administration (FmHA), an agency of the USDA, has certified and provided matching grants to state mediation programs. These state mediation programs are operated primarily by state universities and state departments of agriculture. The USDA mediation programs have allowed farm borrowers and their creditors to work out joint solutions, avoiding human suffering and the costly and time-consuming processes of administrative appeal, foreclosure, and litigation.

### II. HISTORY OF THE USDA MEDIATION PROGRAM

Section 505 of the Agricultural Credit Act of 1987,<sup>1</sup> enacted on January 6, 1988, authorized the Secretary of Agriculture to help states develop USDA Certified State Mediation Programs. In addition to providing for the state mediation certification process, the Act re-

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1. Agricultural Credit Act of 1987 § 505, 7 U.S.C. § 5105 (1988).

quired the FmHA to participate in mediation in certified states and to provide a mediation system for FmHA borrowers in noncertified states through a voluntary meeting of creditors. This was a broad attempt by Congress to deal with problems related to bad debts incurred by farmers during the 1980s.

FmHA wrote a regulation for the administration of the USDA Certified State Agricultural Loan Mediation Program specified in Subtitles A and B of Title V of the Act.<sup>2</sup> This regulation provides the certification requirements a state's agricultural loan mediation program must meet in order for the FmHA and other agencies of the USDA to participate in mediations and to receive a federal matching grant(s) for the operation and administration of the program. The Act requires the Secretary of Agriculture to participate in state agricultural loan mediation programs. The Office of the General Counsel (OGC) has interpreted the duty to participate in mediation to apply only when a state program has been certified by the Secretary of Agriculture as satisfying certain requirements set out in section 501(c) of the Act.<sup>3</sup>

The Secretary of Agriculture delegated the authority to review and certify state agriculture loan mediation programs to the FmHA Administrator. Requirements for certification of a state program include the following:

1. Mediation services should be provided to producers and their creditors that, if decisions are reached, result in mutually agreeable decisions between parties under an agricultural loan mediation program.
2. Programs should be authorized or administered by an agency of the state government or by the governor of the state.
3. Programs should provide for the training of mediators.
4. Programs should provide that the mediation sessions shall be confidential.
5. Programs should ensure that all lenders and borrowers of agricultural loans receive adequate notification of the mediation program.<sup>4</sup>

The Act authorized an appropriation of \$7,500,000 for each of the fiscal years 1988 through 1991, with matching grants limited to the lesser of \$500,000 each year or fifty-percent of the cost of any state program.<sup>5</sup>

The Food, Agriculture, Conservation and Trade Act of 1990<sup>6</sup> extended this authorization through 1995. The Agricultural Credit Im-

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2. Agricultural Loan Mediation Program, 7 C.F.R. § 1946 (1993).

3. Agricultural Credit Act of 1987 § 501(c), 7 U.S.C. § 5101(c) (1988).

4. *Id.*

5. *Id.* at § 5106.

6. Food, Agriculture, Conservation, and Trade Act of 1990, Pub. L. No. 101-624, 104 Stat. 3359 (codified as amended in scattered sections of 7, 12, 13, 15, 16, 18, 19, 21, 22, 25, 26, 42, and 46 U.S.C.).

provement Act of 1992<sup>7</sup> raised the USDA matching grant level from fifty percent to seventy percent of the cost of any state program not to exceed \$500,000 in any fiscal year.

The FmHA has encouraged states to establish mediation programs. The program was originally promoted via certified letters to all governors. A full-time employee is based in the FmHA's national office to coordinate the promotion and management of this program. In addition, the agency has developed two general information mediation brochures: one applicable to states with the certified program, and one applicable to states without the program. The brochures are available to borrowers, their creditors, the FmHA, and other government agency personnel.

The FmHA developed a nationwide roster to identify a source of qualified mediators for FmHA state directors from which bids can be solicited for contract mediators until their state develops a USDA certified program. A videotape entitled "Me, In Mediation?" has been developed by the agency. The videotape will be used to train FmHA personnel on farmer/lender mediation. The video emphasizes the broad approach to mediation and stresses problem-solving negotiation skills in both state-certified and FmHA-contract mediation programs.

A mediation handbook entitled "Me, in Mediation?" has been published and distributed to all 1,700 FmHA county offices as a supplement to the mediation videotape. This handbook will also be used for training state, district, and county office field staff, and will be distributed routinely to all applicants, lenders, and borrowers.

### III. HOW STATE AGRICULTURAL MEDIATION WORKS

State agencies have developed mediation programs to help farmers and creditors by legislative or executive action. Laws governing mediation vary from state to state. In most states, creditors notify a farmer that mediation services are available through the state governor's office before the creditors take formal legal action to foreclose on a loan. The farmer usually has a limited period of time to request mediation or waive the opportunity to use the service. If the farmer requests mediation, the mediation service contacts the farmer to get a list of creditors and suggests a financial analysis or other steps the farmer should take to prepare for mediation. The mediation service then assigns one or more mediators to the case.

Farmers and creditors in some states may select or eliminate mediators offered. Once a mediator or mediator team is selected, all known creditors are advised that a mediation process is being started. If a meeting is scheduled, the parties are then informed of the time,

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7. Agricultural Credit Improvement Act of 1992, Pub. L. No. 102-554, § 22, 106 Stat. 4142 (codified at 7 U.S.C. § 5102(b) (Supp. IV 1992)).

place, and nature of the mediation process. Ground rules are set to ensure that the conference is productive. The mediator confirms that all agree to a few simple ground rules. Each person tells his or her story to ensure that all points of view are presented. The mediator then helps the parties identify information that might be needed to evaluate the situation, sources of expertise, and steps to be taken. The parties develop and record options so each can be considered, and then begin to narrow down the options.

The parties reach preliminary agreements about which possibilities might work and which should not be discussed further, although the farmer and the creditors might talk with others. A caucus might be called. Finally, the mediator helps the parties put all of their agreements in writing. Copies are signed and made available to all participants. If an agreement is not reached, the case is closed, all parties are advised of the outcome, and all are free to pursue other legal courses.

The mediator does not hold evidential hearings as in arbitration. The parties are invited to come to the mediation conference prepared with any evidence and documentation they feel will be necessary to discuss their respective cases. The mediator gathers facts, clarifies discrepancies, acts as a neutral third party, and assists the borrower(s) and creditor(s) in exploring alternatives that they otherwise might not have considered.

The failure of other creditors to participate in mediation does not preclude the FmHA and its borrowers from mutually agreeing to a feasible plan of operation. If other creditors do not participate or are not willing to alter their debt repayment requirements to provide a feasible plan, however, the FmHA may not be able to continue with the borrower. If the mediation process is not successful, the borrower can appeal the adverse decision through the FmHA administrative appeal process.

#### IV. USDA LENDER OBJECTIVES IN MEDIATION

Lenders participate in the mediation process with three primary goals: (1) to explore all options to keep the family in farming; (2) to work with the farmer and other creditors to develop a plan that will benefit the borrower and the creditors; and (3) to make the process of debt reorganization more cost efficient by reaching an agreement that can reduce the number and length of reviews and appeals.

The FmHA and other USDA representatives try to set a constructive tone in mediation and encourage others to do the same. If a loan made by the USDA becomes delinquent, the agency involved will notify the borrowers and inform them that they have the right to request mediation services.

Once the FmHA notifies a borrower of delinquency in payments, the borrower must respond with a request for debt restructuring and a plan by which it may be accomplished. The FmHA will analyze the plan and inform the borrower if debt restructuring or write-down of the debt is applicable. If the plan is viable, the FmHA usually will accept the plan. The FmHA uses a computer program to determine whether the loan can be salvaged by consolidation, rescheduling, reamortization, deferrals, or write-down. The FmHA will request mediation when a financial analysis indicates the agency's servicing options cannot resolve the problem.

## V. NON-USDA LENDERS IN MEDIATION

Non-USDA lenders with financial involvement are not legally required by federal statute to participate in a USDA mediation program. All lenders, however, can discover additional facts and can understand the borrowers' views and evaluate particular issues without violating confidences.

Frequently, informal mediation sessions can help participants develop debt restructuring plans that are more cost effective than foreclosure, prevent delinquencies, and reduce legal costs and staff time associated with court action. Mediation offers both borrowers and lenders the opportunity to reduce hostility and provides the basis for a continuing business relationship.

## VI. EFFECTIVENESS OF STATE AGRICULTURAL MEDIATION

The FmHA has certified twenty state programs since August 1988, including: Alabama, Arizona, Arkansas, Indiana, Iowa, Kansas, Minnesota, Mississippi, Montana, Nebraska, New Mexico, Nevada, North Dakota, Oklahoma, Oregon, South Dakota, Texas, Utah, Wisconsin, and Wyoming. Two states, Mississippi and Montana, withdrew from the program because of state budget restraints.

Since 1989, a total of \$14,777,662 has been obligated for USDA certified state agricultural loan mediation. For fiscal year 1993, states participating in the USDA mediation program have provided over \$2,885,313 as their match for the USDA Mediation Matching Grant Program. The total program budget for fiscal year 1993 was over \$5,885,313.<sup>8</sup>

The FmHA uses the services of the Federal Mediation and Conciliation Service (FMCS) to provide training and mediation assistance in states that do not have a USDA certified mediation program. The FMCS sent a memorandum to the ten district directors, outlining the

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8. Information compiled by Chester A. Bailey, Mediation Coordinator and Special Assistant to the Assistant Administrator, Farmer Programs, Farmers Home Administration, U.S. Department of Agriculture, Washington, D.C. 20250

need for mediation assistance in the area of farmer/lender disputes. The FMCS advised the FmHA that it will assist states where they have the available resources until additional states receive USDA certification and grants to operate their programs.

The USDA mediation program is an important part of the process to ensure that farmers and lenders are able to reach agreements that save money and hopefully enable farmers to stay on the land. State mediation directors report that there are several measures to determine whether their mediation programs have been effective. First, public awareness and the availability of the mediation program may be the most important means of measurement. Because farmer/lender mediation is a relatively new concept in the farm financial area, most farmers are not familiar with mediation or are not aware of its benefit. Farm lenders and borrowers need to be informed about mediation and how it works. Numerous articles and press releases on mediation have appeared in farm magazines, local newspapers, newsletters for the state banking association, state bar associations, and various farm and church organizations. Some states have a mediation advisory board that represents several farm and church organizations and the state banking associations.

Second, all USDA certified mediation programs have received requests for mediation from both borrowers and creditors involved in the financial dispute. One state, Nebraska, reported that requests for mediation are about evenly split between borrowers and creditors.<sup>9</sup> The vast majority of the creditor requests, however, have been made by the FmHA. Most creditors are willing to participate in the mediation process, but are not requesting it themselves.

Third, mutual agreements are being reached between the vast majority of the parties going through the mediation process. Of those cases that complete the mediation process, some sort of mutual agreement is accepted, which is often more than they had prior to the mediation session. State mediation directors report that mediation provides an opportunity for communication between the parties. Often the borrower and creditor have not talked to each other for several years. The mediation request has helped to renew communications between the parties and has resulted in some type of negotiated agreement, thereby reducing the need for litigation, foreclosure, or bankruptcy.

Fourth, the mediation program has provided an alternative means to resolve farm financial disputes which is faster, cheaper, more agreeable to the parties, and confidential. Mediation is significantly cheaper than any type of litigation. For example, no attorney fees are

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9. 1989 NEBRASKA FARM MEDIATION PROGRAM, NEBRASKA DEPARTMENT OF AGRICULTURE, ANN. REP. 1.

necessary since the borrower and lender may represent themselves at the mediation session. However, attorneys can be present at the mediation session if the participants request them. There are other savings involved in mediation as opposed to other forms of dispute resolution. For instance, in most cases, a fee is charged for a trustee to administer an estate in bankruptcy. This would not be the case in any USDA certified state program.

The mediation process is confidential, and since the process does not require the parties to reach an agreement, the parties are usually more receptive to a final agreement. Parties are only required to enter into an agreement of their own choosing; no party will be forced into an agreement by another party or a judge.

Fifth, most parties participating in mediation are satisfied with the mediation process. Some evidence suggests parties are more likely to commit to an agreement if they had a part in drafting it, as opposed to having an agreement imposed upon them. Due to the nature of the mediation program and its newness, measures of the effectiveness of the program to date have been short-term. Generally, the state mediation directors believe that the parties to a mediated agreement will work harder at meeting their obligations under the agreement than those whose obligations are imposed upon them by a court order.

Finally, USDA state mediation programs have made participants aware of other resources available to them. State mediation directors report that participants have been provided with assistance in making the transition to another vocation. Opportunities such as rural education, grants, and other forms of financial aid are discussed with participants. Farm families are not immune to stress, depression, spouse and family abuse, alcoholism, mental breakdown, divorce, and suicide. Through mediation sessions, farm families have been encouraged to contact mental health services, a family physician, self-help groups, or a counselor, as appropriate. State mediation programs have provided a positive atmosphere to help parties discover options to resolve financial problems. USDA state directors have reported that USDA mediation programs are effective and well run. The success of the program has depended largely on communication and ready access between the agencies to immediately resolve areas of disagreement. Some FmHA state directors report that their mediation programs have not been established long enough to comment on the effectiveness of the programs or savings to the states.

## VII. IMPROVING MEDIATION SERVICES TO FARMERS AND LENDERS

The concept of mediation is not new, but the use of mediation as a means to resolve conflict between agricultural borrowers and lenders



is new. Mediation is an unfamiliar process for many borrowers and creditors. While the vast majority of the cases received in the past years have originated as a result of the FmHA's Notices of Primary Loan Servicing Options, efforts are being made by state mediation directors to actively solicit more cases from the Farm Credit System and commercial banks.

It is extremely important that borrowers are prepared with current financial information, have a feasible plan, and have a knowledgeable individual with them should they have difficulty understanding the proceedings. Ongoing training is essential.

Program farmers and lenders need to be continually informed on regulations and available options. Mediators need periodic reminders of the need to be impartial and protective of the rights of all participants. All parties need to be better educated on the tax consequences of the various restructuring options available in attaining a mutual agreement.

Public awareness is essential to make the mediation process work. The importance of meeting schedules and agreed-upon obligations must be stressed to offset any temptation to adopt stall tactics for fear of the unknown.

Three specific recommendations have been offered by state mediation directors. First, delinquent borrowers should be referred to mediation before any formal steps are taken toward either accelerating the loan or foreclosure. The earlier the case is referred to mediation, the more likely the mediation will result in a positive outcome. Second, all USDA agencies should utilize mediation and/or other alternative dispute resolution (ADR) procedures, when appropriate. This is authorized and encouraged in the Administrative Dispute Resolution Act,<sup>10</sup> enacted November 15, 1990.

Finally, Congress should amend mediation provisions of the Agricultural Credit Act of 1987 to include all federal creditors (even the Internal Revenue Service and the United States Attorney General's Office). Currently, only the USDA and the FMCS are covered by the mediation provisions of the Act. Most federal creditors are not bound by the same requirements to restructure loans and mediate disputes as are the FmHA and the FMCS. A significant number of distressed loan cases involve debts to the Small Business Administration (SBA) and the Federal Deposit Insurance Corporation (FDIC). The SBA and the FDIC also often hold their positions junior to the FmHA and the FMCS. Thus, in many cases, a write-down of debt by the FmHA or the FMCS does not allow the development of a feasible plan, but gives the SBA or the FDIC a more favorable lien position.

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10. Administrative Dispute Resolution Act, Pub. L. No. 101-552, §§ 581-593, 104 Stat. 2736 (codified at 5 U.S.C. §§ 581-593 (Supp. IV 1992)).

In many cases borrowers have thought that they could restructure, voluntarily liquidate, or debt settle, only to find that the tax consequences of a voluntary settlement would be so great that they have no alternative except to declare bankruptcy. Often a feasible plan can be developed so borrowers can make restructured loan payments. When the additional tax burden is considered, however, there is no way to develop a feasible plan.

State mediation directors state that, generally, the FmHA has done an excellent job of trying to resolve problem loans, both in and out of mediation. Education and strong legislative support plus increased federal and commercial lender involvement in the mediation process are the primary needs for improving the delivery of mediation services to agricultural producers.

#### VIII. BENEFITS AND COSTS OF STATE AGRICULTURAL MEDIATION

Many benefits of farm loan mediation are largely intangible. Hopefully, as a result of mediation, the farm debt will be restructured so that a positive cash flow allows borrowers to remain on the farm and contribute to rural communities. When agricultural business is lost in a small town, a ripple effect occurs. With each job lost, there is less money spent at the local service station, the grocery store, equipment dealer, and farm supplier. Soon the local tax base is eroded, school budgets are affected, and major local employers go out of business or are disrupted.

Cost savings from agricultural loan mediation have resulted in direct savings to the taxpayer and public and private creditors. Agricultural loan mediation has proven itself to be quicker and less expensive than liquidation. Many of the agreements reached were cases in which the loan could not be restructured, and buyout at net recovery was offered by the FmHA, or another lender had started a liquidation action.

Savings have not been restricted to state treasuries. There have also been savings to the FmHA and other borrowers/creditors when their delinquent loans are resolved because delinquent loans require administrative time and effort, regardless of whether the loans are being paid back. More administrative time is required if the borrower is working through the appeal process. If no payments are being made on the loan, it must be serviced using resources from other loans. This puts a severe strain on lenders if a number of delinquent loans exist. Mediation helps resolve these loans and reduce the strain and administrative costs.

Several of the mediation states, including Iowa, Kansas, Minnesota, Nebraska, North Dakota, and South Dakota, have worked with the United States Department of Labor to help dislocated farmers and

ranchers. Farm families often have little experience with the local job service office. They rely on agricultural and lending organizations for their livelihood, and they come to place great trust in the agricultural mediation programs that employ statewide mediation financial analysts who counsel farm and ranch operators on credit issues and renegotiate between these two groups.

A recent Texas Tech University study of the Agricultural Loan Mediation Program in Texas<sup>11</sup> showed a benefit cost ratio of 4.48 to 1.<sup>12</sup> Total benefits to creditors attributable to the mediation of delinquent or distressed agricultural loans were estimated for the entire period since the beginning of the program on October 1, 1988. During the four-year period ending September 30, 1992, 211 cases were settled through agricultural loan mediation.<sup>13</sup>

During the period of October 1, 1988, through September 30, 1992, the costs of operating the Texas Agricultural Loan Mediation (TALM) Program were \$2,671,482. Comparing the estimated benefits to creditors of \$11,978,048 with the costs of mediation services of \$2,671,482, creditors received an estimated \$4.48 in benefits for every \$1.00 spent by TALM in providing mediation services.<sup>14</sup>

A comparison of benefits to the FmHA with costs of the program in terms of federal funding showed that the program spent \$1,334,946 of federal grant funds to provide mediation services over its four-year life. The projected benefits to the FmHA from loans that were restructured during this same time period were \$7,686,097. The estimated benefit cost ratio for the federal government was \$5.76 for each \$1.00 in federal grant funds spent in providing mediation services.<sup>15</sup>

The benefits to the FmHA were estimated as the difference between the face value of the restructured loan(s) and the net recovery value. Benefits to creditors were estimated as the difference between the face value of their loans in the restructuring agreement and the "market value" of collateral which would be available to satisfy their loans in an involuntary liquidation.

In the cases in which the borrower bought out the FmHA loan(s) at net recovery value, no benefits were assigned to the FmHA, since the amount received by the FmHA under the voluntary agreement was the same as the amount the FmHA would have received in an involuntary liquidation. This procedure assumes that the borrower and all creditors will carry out the restructuring agreement.

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11. 1992 TEXAS AGRICULTURAL LOAN MEDIATION PROGRAM, TEXAS TECH UNIVERSITY, Ann. Rep.

12. *Id.* at 17.

13. *Id.* at 16.

14. *Id.* at 17.

15. *Id.*

The Texas Tech study discussed the numerous benefits of mediation.

[I]t is generally accepted that mediation usually allows a dispute to be resolved more rapidly than litigation. Likewise, the mediation process is usually a less expensive method for resolving disputes than the litigation process. Perhaps more importantly, the mediation process is better suited for resolving disputes without destroying the relationship between the disputants.<sup>16</sup>

Using estimates developed in the Texas Tech University benefit cost study, the returned benefits to the federal government in the states participating in the agricultural loan mediation program will be greater than \$70,341,671 (\$5.76 benefit cost ratio for the federal government multiplied by \$14,777,662 total matching grants obligated minus federal grant fund cost).

There are other savings from using the agricultural loan mediation program. When a voluntary settlement is reached through mediation, lenders avoid legal, administrative, management, marketing, and interest costs. A voluntary settlement enables the borrower to remain a productive business member of society, and local, state, and federal governments avoid costs associated with reduced economic activity, unemployment, welfare, and social unrest in the rural community. When loans are restructured, most creditors will receive at least a portion of the debts owed to them.

The Internal Revenue Service's regional office in Wisconsin is participating in all mediation cases when requested. This cooperation is an example of continuing efforts to work with other government agencies at the state and federal levels to improve participation in farm mediation.

#### IX. USDA CERTIFIED STATE MEDIATION IS CONSUMER FRIENDLY

Secretary of Agriculture Mike Espy is leading the way to reinvent government. One aspect of this reinventing is making government work for the people. These sentiments are echoed by the Under Secretary for Small Community and Rural Development, Bob Nash. Nash, who served as facilitator for the Arkansas mediation program under former Governor Bill Clinton, says the mediation concept mirrors the USDA's farmer friendly message. "This Administration is committed to the consumer. Mediation can be one of the integral parts of this commitment as we work to reinvent government. It is consumer friendly. It is farmer friendly."<sup>17</sup>

Additionally, Nash noted the success of mediation in Arkansas. "The Arkansas mediation program has been helpful in maintaining

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16. *Id.* at 9.

17. Bob Nash, Remarks at the FmHA Comprehensive National Training Program on Resolution of Problem Loans in Washington, D.C. (June 22, 1993).

movement toward solving debt problems. Mediation has been effective in allowing the farmer a better understanding of what is going to happen. It is that simple and it works."<sup>18</sup>

The USDA will continue to be a major player with mediation. The USDA state mediation program is a giant step in Secretary Espy's efforts to reinvent the USDA to work better for the people.

Based upon the experience of the past five years, the Administration can support an extension of the USDA Certified State Mediation Program beyond the present sunset date of 1995. According to Vice President Al Gore, "[t]he Farmers Home Administration has used ADR on foreclosure cases not only saving money, but actually avoiding foreclosure on several families. This type of innovation should spread faster and further across the federal government."<sup>19</sup>

Senator Kent Conrad, a United States senator from North Dakota, introduced the USDA National Appeals Division (USDA-NAD) Act of 1993,<sup>20</sup> on August 6, 1993. This bill would allow USDA state-certified mediation programs to mediate disputes involving wetland determinations, farm program compliance, farm creditors rural water loans, grazing on national forest lands, and pesticides. Congressman Tim Johnson, a United States representative from South Dakota, introduced the companion legislation.<sup>21</sup>

Congressman Earl Pomeroy, a United States representative from North Dakota, introduced the Agricultural Mediation Improvement Act of 1944,<sup>22</sup> on March 24, 1994. This legislation would also expand the types of programs that the USDA-certified mediation states could mediate. These could include disputes arising from commodity program decisions, conservation compliance determinations, and wetland determinations. With these types of issues, USDA certified state mediation can be successful and cost-effective, as Vice President Gore's National Performance Review recognized in proposing an increase in the use of alternative dispute resolution techniques.

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18. *Id.*

19. VICE PRESIDENT AL GORE, REPORT OF THE NATIONAL PERFORMANCE REVIEW, CREATING A GOVERNMENT THAT WORKS BETTER & COSTS LESS, 119 (1993).

20. S. 1425, 103d Cong., 2d Sess. (1993).

21. H.R. 2950, 103d Cong., 2d Sess. (1993).

22. H.R. 4153, 103d Cong., 2d Sess. (1994).