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Constitutionality of Mandatory Farmer-Lender Mediation: The Minnesota Plan - Laue v. Production Credit Association, The

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THE CONSTITUTIONALITY OF MANDATORY FARMER-LENDER MEDIATION: THE MINNESOTA PLAN

Laue v. Production Credit Association[1]

I. INTRODUCTION

In March of 1986, the Minnesota legislature adopted an omnibus farm bill. A principal part of this bill was the "Farmer-Lender Mediation Act"[2] (hereinafter Act). The Act requires mandatory mediation notice in the case of any debt foreclosure proceedings brought against farm debtors.[3] The Act was scrutinized by the Minnesota Court of Appeals in a case of first impression in *Laue v. Production Credit Association.*[4]

II. THE CASE

The constitutionality of the Act was challenged in *Laue*[5] and the companion case of *Kelly v. Federal Land Bank.*[6] In *Laue*, Respondent Production Credit Association (P.C.A.) sought a money judgment against Petitioner Laue, as well as recovery of secured collateral.[7] In *Kelly*, Petitioners had difficulty with the repayment of certain loans secured by a mortgage on their farm.[8] After negotiations and a bankruptcy petition was filed and dismissed, the Respondent instituted foreclosure proceedings.[9] In both *Laue* and *Kelly*, the petitioner/debtors did not receive mediation notices, but did request mediation in a timely manner as was their right under the new bill.[10] In both cases, the trial courts denied motions for a stay of proceedings and motions for tem-

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1. 390 N.W.2d 823 (Minn. Ct. App. 1986).
2. 1986 Minn. Laws chap. 298 (codified at MINN. STAT. §§ 583.20-.32 (1986)).
3. *Id.* at § 583.26(1).
4. 390 N.W.2d at 823.
5. *Id.* at 829.
6. 390 N.W.2d 823 (Minn. Ct. App. 1986). Both *Laue* and *Kelly* were heard and decided together as both cases were based upon similar facts and presented identical issues as to the validity of the Act.
7. *Id.* at 825.
8. *Id.*
9. *Id.*
10. *Id.* at 825-26. MINN. STAT. § 583(2)(c) provides in part:
> If a debtor has not received a mediation notice and is subject to a proceeding of a creditor enforcing a debt against agricultural property . . . the debtor may file a mediation request with the director. The mediation request form must indicate that the debtor has not received a mediation notice.

porary restraining orders brought by the plaintiffs in an effort to allow time for mediation.[11] The courts denied these motions, finding the Act only applied to proceedings commenced after the effective date of the Act.[12] On appeal, both Laue and Kelly sought a writ of mandamus compelling the trial court to stay foreclosure pending mediation.[13]

III. THE ACT

The Minnesota Farmer-Lender Mediation Act was enacted as a result of the economic crisis on the farm and was designed to preserve the integrity of the farm economy of Minnesota.[14] In addition to providing for voluntary mediation,[15] the Act requires that before a creditor can garnish, levy or execute on, seize or attach agricultural property, he must first serve upon the debtor a notice of the right to mandatory mediation.[16] The debtor must then file a mediation request with the Director within 14 days.[17] If no such request is filed, the debtor is deemed to have waived mediation.[18] After the request for mediation is filed, debt proceedings may not continue until 90 days after the initiation of mediation or a mediation agreement is reached.[19]

The Act also contains certain requirements of good faith. In the event a

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11. *Laue*, 390 N.W.2d at 825.

12. *Id.* at 826. The Minnesota legislature adopted the omnibus farm bill containing the Act in March of 1986. The Act became effective on March 22, 1986. *See supra*, note 2. In both cases, foreclosure and replevin proceedings were commenced against the farm debtors prior to the effective date. Therefore, the trial courts ruled that the Act had no retroactive application.

13. *Laue*, 390 N.W.2d at 825.

14. MINN. STAT. § 583.21 states:

> The Legislature finds that the agricultural sector of the state's economy is under severe financial stress due to low farm commodity prices, continuing high interest rates, and reduced net farm income. The suffering agricultural economy adversely affects economic conditions for all other businesses in rural communities as well. Thousands of this state's farmers are unable to meet current payments of interest and principal payable on mortgages and other loan and land contracts and are threatened with the loss of their farmland, equipment, crops and livestock through mortgage and lien foreclosures, cancellation of contracts for deed, and other collection actions. The agricultural economic emergency requires an orderly process with state assistance to adjust agricultural indebtedness to prevent civil unrest and to preserve the general welfare and fiscal integrity of the state.

15. *Id.* at § 583.25.

16. *Id.* at § 583.26.

17. *Id.* at § 583.26(2)(a).

18. *Id.* at § 583.26(2)(b).

19. *Id.* at § 583.26(5)(a). This provision was amended to read, "until 90 days after the date the debtor files a mediation request with the Director." 1987 Minn. Laws ch. 292.

creditor fails to mediate in good faith, a trial court can require good faith mediation for up to 60 days.[20] If the creditor still fails to cooperate, the length of time can be extended.[21] The requirement of good faith is applied to the debtor as well.[22] It should be noted that portions of the Act have been amended since this case was decided.[23] However, the amendments were not passed as a hostile reaction to the *Laue* holding, but rather as a means of clarifying the language of the Act.

IV. THE DECISION

The court of appeals considered two principal issues. First, whether the Act applied retroactively, as the debtor's contended, or prospectively only.[24] The court concluded the statute as worded would permit the debtor to request mediation in the absence of mediation notice even though no notice was required by law when the collection proceedings were initiated.[25] This conclusion made it unnecessary for the court to reach a decision on the retroactivity issue.[26]

The second issue before the court involved constitutional challenges to the Act.[27] Respondent F.L.B. challenged the Act under two separate constitutional provisions.[28] First, Respondent argued the Act violated the contract clause of both the United States and Minnesota constitutions as an impairment of the lenders contract.[29] A second related argument tendered by Respondent was that the Act's interference with their contract rights violated due process.[30] These constitutional challenges are the focus of this note.

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20. MINN. STAT. § 583.27(3).
21. *Id.*
22. *Id.* at § 583.27(4).
23. 1987 Minn. Laws ch. 292. These amendments and deletions to the original Act represent primarily only procedural changes.
24. *Laue*, 390 N.W.2d at 826. The statute was passed in March 1986, after foreclosure proceedings had been instituted against all petitioners. *Id.* at 825.
25. *Id.* at 828. The plain language of the statute states, "if a debtor has not received a mediation notice and is subject to a proceeding of a creditor enforcing a debt . . . the debtor may file a mediation request with the commission." *Id.* at 827. The court found this language "constitutes a clear and manifest expression of legislative intent to afford mediation to all agricultural debtors." *Id.* at 828. The facts before the court indicated that the petitioners did not receive mediation notice and were subject to proceedings by their creditors. *Id.* at 829. The statute as interpreted and the facts as given made it unnecessary for the court to decide the issue on the basis of retroactive application. *Id.*
26. *Id.* at 829.
27. *Id.* at 826.
28. *Id.*
29. *Id.*
30. *Id.*

A. *Impairment of Contract*

The court first addressed the issue of unconstitutional impairment of contract. The Contract Clause[31] of the U.S. Constitution has been construed as allowing the states to reserve some power to modify contract terms when the public interest requires.[32] However, at the same time, the contract clause is a viable restriction on the powers of a state. If a state undertakes to alter substantially the terms of a contract, it must justify the alteration.[33] In *Laue*, the court refers to *Christensen v. Minneapolis Municipal Employees Retirement Board*,[34] in considering whether the Act was constitutional. The *Christensen* case sets out a three part test of constitutionality.[35] While this standard would have been an appropriate gauge as to the constitutionality of the Act, Respondent F.L.B. did not specifically address any of these factors.[36]

The court looked to prior Supreme Court precedent in deciding the impairment of contract issue. The court compared *Laue* and *Kelly* to another Minnesota case, *Home Building & Loan Association v. Blaisdell*.[37] In *Blaisdell*, the Mortgage Moratorium Law of 1933[38] was challenged as being repugnant to the contract, due process, and equal protection clauses of the U.S. Constitution.[39] The 1933 law provided for a stay of judicial proceedings in farm foreclosures.[40] The 1933 law was an attempt to relieve an economic crisis that was severely affecting the State of Minnesota and its farming economy.[41] The United States Supreme Court in *Blaisdell* held that the Mortgage Moratorium Law of 1933 was a valid exercise of the state of Minnesota's police power.[42] The court so held by recognizing the legitimate public purpose of alleviating a serious farm crisis and by finding no actual impairment of the underlying debt.[43]

In *Laue*, the Minnesota Court of Appeals held that the stay pending mediation under the present Act did not impair the creditor's contract on the

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31. U.S. CONST. art. I, § 10 states, "no state shall . . . pass any . . . law impairing the obligation of contracts."

32. *See* Allied Structural Steel Co. v. Spannus, 438 U.S. 234 (1978).

33. *See* White Motor Corp. v. Malone, 599 F.2d 283 (8th Cir. 1979).

34. 331 N.W.2d 740 (Minn. 1983).

35. *Id.* at 742. Christensen set forth the following factors: "(1) Does the Act impose a substantial impairment, (2) has the state shown a significant and legitimate public purpose for the Act, and (3) is the action taken by the legislature reasonable in light of the public purpose?" *Id.*

36. *Laue*, 390 N.W.2d at 829.

37. 290 U.S. 398 (1934).

38. 1933 Minn. Laws ch. 339.

39. *Blaisdell*, 290 U.S. at 444-45.

40. 1933 Minn. Laws ch. 339.

41. *Id.*

42. *Blaisdell*, 290 U.S. at 444-45.

43. *Id.*

debt itself.[44] The court also found the Act served a legitimate public purpose and was "carefully tailored" to protect this purpose without "unreasonably burdening creditors."[45] The Act was "carefully tailored" in that it "limited the time for mediation, impose[d] obligations of good faith upon participating debtors and creditors, and repealed the Act effective July 1, 1988.[46]

B. *Due Process Considerations*

The second constitutional challenge raised by Respondent F.L.B. alleged that the Act violated due process of law because the mandatory mediation required by the Act interfered with its contract rights.[47] Due process requires that state legislation which interferes with a protected right be "rationally related to a legitimate governmental purpose."[48] The court followed its analysis under the impairment of contract argument, finding that the Act did not defeat the creditor's interest, and was clearly related to a legitimate legislative purpose of alleviating the farm crisis.[49] This finding was all that was necessary to satisfy the due process standard.

The court again relied on a previous decision upholding the Minnesota Mortgage Moratorium Law of 1933.[50] The Minnesota Supreme Court upheld the 1933 law in *State ex rel. Lichtscheidl v. Moeller*.[51] The court held that the legislature's knowledge of the economic crisis then being suffered made the 1933 law a valid exercise of Minnesota's police power as an emergency measure to temporarily protect property owners and the general welfare.[52] The *Lichtscheidl* case is relevant to *Laue* and *Kelly* because it shows that without a showing of serious or substantial damage to the interest of a contract-holder/creditor, the Act's interference with the contract interest will be held constitutional against a due process challenge.[53] Therefore, since a rational relationship existed in this case, and no serious damage was done to F.L.B.'s interest, the Act withstood the due process challenge.[54]

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44. *Laue*, 390 N.W.2d at 829. The court reasoned that the Act only required a change of remedy which did not "materially lessen" the value of the contract. *Id.*

45. *Id.* at 829. The public purpose was the alleviation of the serious farm crisis. *Id.*

46. *Id.*

47. *Id.* at 830.

48. AFSCME Councils v. Sunquist, 338 N.W.2d 560, 574-575 (Minn. 1983).

49. *Laue*, 390 N.W.2d at 830.

50. *Id.*

51. 189 Minn. 412, 419, 249 N.W. 330, 333 (Minn. 1933).

52. *Id.*

53. *Id.* at 419, 249 N.W.2d at 333.

54. *Laue*, 390 N.W.2d at 830.

V. ANALYSIS

The significance of the *Laue* decision is difficult to dispute. This significance is not only manifested by all the possible repercussions of the Act, but also by the massive number of farm-debtors who requested mediation within the first six months after passage of the Act.[55] A critical analysis provides insight into the significance of the case, but more importantly into the Farmer-Lender Mediation Act itself.

First, exactly what is the Act? Is it a true attempt by the Minnesota legislature to alleviate a worsening economic crisis or is it merely a 90 day moratorium on farm foreclosures? Based on the legislative findings accompanying the Act, it appears that the legislature felt that the agricultural economy truly was in severe financial shape.[56] The *Laue* court noted during its analysis of the contemporaneous legislative history of the Act that there was an apparent concern for farmers suffering from the effects of the agricultural economy.[57] The conclusion would seem to be that there was a genuine concern among the legislature for the agricultural crisis and its effect on the individual farm debtor.

However, the argument can be made that the Act is no more than another mortgage moratorium not unlike the one employed in 1933.[58] There is some merit to this argument that the stay of proceedings employed by the Act is the same as that used in the 1933 Law, with the exception that the Act's stay of proceedings will probably last no more than 90 days.[59] In any event, the length of the stay is sufficient to elicit considerable lender anger in that it frustrates collection attempts and causes them to lose money.[60] One should also note that since the purpose of the Act is mediation, ninety days is not that long a period and is probably suitable for that purpose.

A second interesting question with regard to legislation designed to alleviate an economic farm crisis is what have other states done in the field, and how does their legislation compare to Minnesota's? The most common reaction of most states has simply been to pour money into various types of loan programs designed to aid indebted farmers.[61] This appears to be the extent of

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55. Welsh, *Midwest Mediators Do Brisk Business*, FARM JOURNAL Oct. 1986, at 29. Welsh notes, "of the 4,067 credit notices that have gone out, 2,216 farmers have asked for mediation says Matt Metz, operations manager of the Minnesota Mediation Service."

56. MINN. STAT. § 583.21.

57. *Laue*, 390 N.W.2d at 828; *see also supra* note 14 and accompanying text.

58. 1933 Minn. Laws ch. 339.

59. MINN. STAT. § 583.26(5).

60. *See* Bennett, *Angry Minnesota Attorney General Asks for Probe of Farm Credit System*, 151 AM. BANKER 9 (July 11, 1986). Bennett states, "the St. Paul bank has said the legislation would cost its farmer members at least 50 million dollars in the first year." *Id.*

61. *See* Bennett, *How Banks Are Affected by Programs of Midwestern States to*

the reaction of most states.[62] However, Iowa did implement mandatory mediation similar to the Minnesota program.[63]

The Iowa Farm Mediation Statute[64] was made effective on May 30, 1986, just two months after the Minnesota Act and contains the same sunset provision of July 1, 1989. There are several similarities in these states' mediation statutes. Both provide for mandatory mediation.[65] Both set up a fairly comprehensive structure through which mediation will be conducted.[66]

There are, however, significant differences in the statutes. The Iowa statute does not contain the Minnesota requirement of "good faith" mediation on the part of both debtor and creditor.[67] Nor does it contain Minnesota's allowance to the farm-debtor of "necessary living expenses."[68] The statutes also differ as to qualification for the program. The Iowa statute calls for mandatory mediation whenever the secured farm-debt is greater than twenty-thousand dollars on agricultural land principally used for farming.[69] However, in Minnesota any farm debtor that owns or leases 60 acres or more and had twenty-thousand dollars in gross receipts in the preceding year may apply for mediation.[70] Another significant difference between the two statutes is that the length of time allowed for mediation in Minnesota is ninety days,[71] but in Iowa, essentially forty-two days.[72] The time allowed in both states runs from the time the mediation service receives notice.[73]The last important difference has to do with the effect of the agreement reached in mediation between the farm-debtor and the lender. In Iowa, the agreement reached is considered a legally binding contract.[74] This is also true of Minnesota, with one important qualification—that anytime within the first five days of its formation the contract can be rescinded by either party.[75]

Given the fact that this comparison is a limited one, it does show the broader coverage of the Minnesota Act as compared to another state's statute. However, it is useless to note the expansive language of the Minnesota Act

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Help Farmers, 151 AM. BANKER 24 (April 1, 1986). With the exception of Kansas, which has a bank-instituted voluntary mediation program, no other states have made significant movement toward farmer-lender mediation. *Id.*

62. *Id.*
63. IOWA CODE § 654A (Cum. Ann. 1987).
64. IOWA CODE ANN. § 654A.
65. MINN. STAT. § 583.26; IOWA CODE § 654 A.6.
66. *Id.* at §§ 583.20-.32; IOWA CODE §§ 654 A.1-.14.
67. MINN. STAT. § 583.27.
68. *See id.* at § 583.22(7)(b).
69. IOWA CODE § 654A.4.
70. MINN. STAT. § 583.24(2)(b).
71. *Id.* at § 583.26(5).
72. IOWA CODE § 654A.10.
73. *See supra* notes 71-72.
74. IOWA CODE § 654A.11(2).
75. MINN. STAT. § 583.26(9)(c).

without drawing some insights as to its purpose. The purpose of the Act reflects a legislative intent to provide effective mediation to the largest number of farm-debtors and to foster communication between the farmer-debtor and the lender. This intent is best evidenced by focusing on the final passage of the legislative findings accompanying the Act. The findings state, "the agricultural economic emergency requires an orderly process with state assistance to adjust agricultural indebtedness to prevent civil unrest and to preserve the general welfare and fiscal integrity of the state."[76] Furthermore, this intent is backed by the Act's provisions of mediation services free of charge to practically every farm-debtor for a period up to ninety days during which either party can be compelled to mediate in good faith, and to reach an agreement that can be rescinded by either party within five days of being reached.[77] Therefore, the intent and purpose of the Act to provide an orderly process of debt adjustment and to open the lines of communication between the farm-debtor and lender have every chance of success.

The last and perhaps most important question of this analysis is whether this mediation has furthered the above goals or, more simply stated, "has it worked?" An official study conducted after the first six months of the program by the Minnesota Extension Service showed approximately 2,600 cases were submitted to mediation.[78] Of those 2600 cases, approximately 752 had reached a settlement agreement.[79] In a subsequent unofficial study conducted by the ABA Banking Journal which focused only upon the numbers involved, it was found that in the first nine months of the program, 4,821 cases went to mediation.[80] Of those cases, 542 were settled prior to mediation, 1090 agreed to continue mediation, 1688 reached agreements, and in only 223 cases did the parties agree to terminate mediation.[81]

The statistics involved show that mediation between farmers and lenders is working to some extent. However, the question of overall program success should also be viewed with regard to the human dynamics of the mediation process. When asked the question, "is either group any better off due to the mediation process?," both farmers and lenders responded as would be expected from their respective groups.[82] The average lender felt the farmer in mediation was better off than before mediation, whereas the lender viewed his position as much worse with the requirement of mediation.[83] However, 12% of the lenders felt they were in better shape, and 34% were still undecided.[84]

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76. *Id.* at § 583.21.

77. *See supra* notes 72-74; *see infra* notes 77-78.

78. *See* Minnesota Extension Service, *Farm Credit Mediation Evaluation Report* (Dec. 1986) (available from Minnesota Legislative Library).

79. *Id.* at 37.

80. Clark, *Taking it to Mediation*, 150 A.B.A. BANKING J. 36 (1987).

81. *Id.*

82. *Farm Credit Mediation Report*, at 17-21.

83. *Id.*

84. *Id.* at 21.

Therefore, while there was a clear consensus of 54% of the lenders against the program, that amount of lender disapproval is not surprising given the initial and general types of lender hostility that are encountered in programs such as this one.[85] What is surprising is that nearly 50% of the lenders had either favored the program or remained undecided, thus overcoming any initial bias or hostility and recognizing the program of mandatory mediation for its merits.[86] The average farmer completing mediation overwhelmingly felt (73%) they were better off after mediation.[87] Farmers also felt (58%) that lenders were better off after going through the mediation process.[88]

Based upon the facts and figures cited here and those evaluated by the Minnesota Extension service, the service deemed the mediation program a success.[89] This success was seen in three principal benefits:

> (1) Farmers, as a result of mediation, are more prepared for current and future decision making as they contemplate options in or out of farming.
> (2) Improved communications between farmers and lenders that resulted from mediation.
> (3) The program fostered peaceful change within communities. Frustration and tension were minimized due to mediation which provided a constructive process for resolving indebtedness.[90]

The above conclusions regarding the success and benefits of the program clearly indicate that the mediation program can and does work. These results further show that the process of mediation between farmers and lenders has effectively promoted all the goals of the Minnesota Legislature.

VI. CONCLUSION

The case of *Laue v. Production Credit Association* may not have been a landmark in jurisprudential theory, but it did serve as the judicial stamp of approval for a process badly needed for the state of Minnesota's beleaguered farm economy. The process devised (mediation) was found not to be an impairment of lender contract rights or an infringement of due process of law. The mediation employed has proven successful and consistent with the goals of the legislative Act. Therefore, it is not surprising that the Minnesota Court of Appeals upheld the validity of the Farmer-Lender Mediation Act given its overall success and the positive effect of the mediation program—the provision of a system of mediation that alleviates many of the economic hardships suffered by both Minnesota farmers and lenders.

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85. *Id.*
86. *Id.*
87. *Id.* at 17.
88. *Id.* at 21.
89. *Id.* at 17.
90. *Id.* at 1.