# COMBINING THE ACADEMIC WITH THE PRACTICAL: A MEANINGFUL FRAMEWORK FOR MORE EFFECTIVELY RESOLVING DISTRESSED AGRICULTURAL LOANS

*Michael D. Fielding†*


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† Michael D. Fielding is a partner in the Food & Agribusiness unit of Husch Blackwell LLP in Kansas City, Missouri who focuses his practice on helping lenders successfully resolve distressed agricultural and commercial loans. Listed in the 2021 edition of Best Lawyers in America, he has been named multiple times as a "Best of the Bar" honoree by the Kansas City Business Journal. He is licensed in Missouri, Kansas, and Iowa and is board certified in Business Bankruptcy by the American Board of Certification.

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## Abstract

*While there is much academic research regarding sound decision-making processes, as well as research regarding myriad aspects of distressed consumer and commercial loans, there is very little research addressing troubled agricultural loans. This Article seeks to fill that void by drawing upon the existing literature from these diverse areas and combining it with a practical framework so lenders may more effectively resolve distressed agricultural loans. Sound decision-making begins by recognizing the critical traits of the major parties involved in a troubled farm loan—the lender, borrower, third-party creditors, the legal system, judges, and attorneys. Understanding these traits enables a lender to identify each party's key incentives and better predict how each party will act. Sound decision-making then requires consideration of common cognitive errors that impede good decisions. Recognizing the decision errors that impact each of*

*the major parties provides further clarity on their expected actions. Building upon these stepping-stones, this Article then considers seven key "hinge points" that occur in a distressed loan. A hinge point is an event occurring over a relatively short period of time that has a major impact on the recovery the lender ultimately realizes on the loan. By recognizing when a hinge point is occurring and then actively working to make the right decision at that critical juncture, the lender enhances the likelihood of a better outcome. Next, this Article addresses key practices that should be employed at the various hinges to enhance the likelihood of a better outcome for a distressed agricultural loan. Finally, this Article identifies additional areas for further academic research.*

## I. INTRODUCTION

The objective of this Article is to use key insights from academic literature and combine them with a practical framework to develop a better process to enable lenders to resolve distressed agricultural loans more effectively. To put the importance of this topic into perspective, consider a study of more than 1,000 major corporate decisions over a five-year period that looked at how much of the variance in outcomes was explained by the quality of the process versus the quantity and detail of the analysis.[1] The authors of the study concluded that "process mattered more than analysis—by a factor of six."[2] In today's competitive business environment, it is critical that lenders have a process to help them make sound decisions regarding the resolution of distressed loans. As a practical matter, there is a well-established field of literature that has delved deeply into decision-making errors.[3] There is also a significant body of literature that has looked at a myriad of issues involving commercial and consumer distressed debt issues.[4] Unfortunately, there is very little academic research that discusses distressed agricultural loans.[5] Furthermore, the author of this Article is not aware of any

1. *See generally* Dan Lovallo & Olivier Sibony, *The case for behavioral strategy*, MCKINSEY Q., Mar. 2010, https://www.dea.univr.it/documenti/OccorrenzaIns/matdid/matdid176416.pdf [https://perma.cc/3278-MSDF].

2. *Id*. at 6.

3. *See, e.g.*, Edmund T. Rolls et al., *Decision-Making, Errors, and Confidence in the Brain*, 104 J. NEUROPHYSIOLOGY 2359 (2010).

4. *See, e.g.*, Jennifer Taylor & Maiah Parks, *Legal Considerations for Distressed Debt Investors*, LAW.COM (Aug. 26, 2020, 7:00 AM), https://www.law.com/therecorder/2020/08/26/legal-considerations-for-distressed-debt-investors/?slreturn=20210104110840 [https://perma.cc/7CEQ-QZU7].

5. *See* Bruce Greig et al., *Farmers' Characteristics and the Propensity to Reduce Debt: The Case for New Zealand (NZ) Primary Producers*, 79 AGRIC. FIN. REV. 614 (2019); Saptarshi Mukherjee et al., *Borrowers' Distress and Debt Relief: Evidence from a Natural*

literature that has attempted to build a sound decision-making framework for the resolution of distressed agricultural loans in the United States.

The dearth of academic research in this area is surprising given the economic impact of agriculture generally. For example, in 2019, farms in the United States contributed $136.1 billion to gross domestic product.[6] This figure is a subset of the $1.109 trillion that agriculture, food, and related industries contributed to the United States' GDP that same year.[7] There were approximately 22.2 million full-time and part-time jobs in agriculture, food, and related industries in 2019, with 2.6 million of these being directly on the farm.[8] While the sheer size of agriculture and food-related business in the United States is astounding, it must simultaneously be recognized that the past few years have been very difficult for farmers. Researchers from the United States Department of Agriculture (USDA) noted farm sector income peaked in 2012 but farm debt has continued to rise.[9] Farm real estate is no longer quickly appreciating and, in some areas, prices have begun to decline.[10] The cost of borrowing also increased between 2016 and early 2019 as interest rates rose.[11] To further compound matters, the 2019 trade war with China and the 2020 COVID-19 pandemic have been a sharp one-two punch to farmers, leaving many agricultural loans in trouble.[12]

*Experiment*, 61 J.L. & ECON. 607 (2018); Ravi Anand, Essay, *Waiver of Agricultural Loans: Social Justice or a Travesty Thereof?*, 15 DRAKE J. AGRIC. L. 287 (2010); Chester A. Bailey, *The Role of Mediation in the USDA*, 73 NEB. L. REV. 142 (1994); Gary D. Condra, *Representing Agricultural Clients in Mediation*, 73 NEB. L. REV. 154 (1994); Thomas P. Guarino, *Review Ability of Administrative Determinations Under 7 U.S.C. § 2001: Debt Restructuring and Loan Servicing*, 1 SAN JOAQUIN AGRIC. L. REV. 57 (1991); Christopher R. Kelley & Barbara J. Hoekstra, *A Guide to Borrower Litigation against the Farm Credit System and the Rights of Farm Credit System Borrowers*, 66 N.D. L. REV. 127 (1990); Ken D. Duft & Gayle S. Willet, *Analysis of Distressed Loans under the Agricultural Act of 1987*, 53 J. ASFMRA 7 (Oct. 1989).

6. *Ag and Food Sectors and the Economy*, USDA (Jan. 15, 2021, 2:41 PM), https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/ag-and-food-sectors-and-the-economy/ [https://perma.cc/SL45-GA5A].

7. *Id*.

8. *Id*.

9. NIGEL KEY ET AL., FINANCIAL CONDITIONS IN THE U.S AGRICULTURAL SECTOR: HISTORICAL COMPARISONS, *in* USDA ECON. INFO. BULL. NO. 211, at iii (Oct. 2019), https://www.ers.usda.gov/webdocs/publications/95238/eib-211.pdf?v=7496 [https://perma.cc/Y8X5-J2NJ].

10. *Id.*

11. *Id.*

12. Carolyn Duren & Nathaniel Melican, *Agriculture loan delinquencies hit 8-year high as farmers grapple with COVID-19*, S&P GLOBAL (June 29, 2020), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-

These challenges have not left banks unscathed either. Interest rates for lending have been historically low for some time and are expected to remain that way for the foreseeable future.[13] This puts lenders in a difficult position because the depressed-rate environment makes it more difficult to turn a profit. The thinner margins necessitate that when loans become troubled, lenders must act even more prudently to maximize the ultimate loan recovery. This is particularly acute in the agricultural sector where farmers are increasingly operating on thinner margins in an increasingly competitive global economy.[14]

Additionally, the growing complexity of agricultural borrowers frequently leaves responsible loan officers exclaiming that each situation is unique and must be dealt with on its own special merits, and many loan officers lack experience dealing with troubled loans. Furthermore, loan officers focused on the details of a situation frequently lack the global perspective needed to methodically resolve a distressed debt. This lack of broad perspective can hurt the lender. For example, it is possible that the loan officer successfully applied a particular tactic to resolve a distressed debt in a prior situation. But, if that same tactic were broadly applied to many situations, one would find that the successful results would rarely be repeated. Hence, the key challenge for the lender is identifying the methodologies, actions, and steps that regularly have meaningful results for a wide array of loans versus actions or steps that should not be widely applied to loans because they are outliers—i.e., they anecdotally helped resolve a situation in the past but may not materially aid the lender in accomplishing its objectives.

Fortunately, there is a framework that can be broadly applied to distressed agricultural loans to better help the lender reach a successful resolution. Specifically, over the course of a troubled loan there are certain key hinge points that occur where the lender's actions, or inactions, can dramatically change the course of the loan. Succinctly stated, a hinge point is an event occurring over a relatively short period of time that has a major impact on the recovery the lender ultimately realizes on the loan.

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headlines/agriculture-loan-delinquencies-hit-8-year-high-as-farmers-grapple-with-covid-19-59033978 [https://perma.cc/5572-VGYW].

13. *Ultra-Low Interest Rates Are Here to Stay: 2021 Central Bank Guide*, BLOOMBERG (Jan. 4, 2021, 6:01 PM), https://www.bloomberg.com/news/articles/2021-01-05/ultra-low-interest-rates-here-to-stay-2021-central-bank-guide [https://perma.cc/2DT4-TQGS].

14. *See* BRENT A. GLOY ET AL., THE GREAT MARGIN SQUEEZE: STRATEGIES FOR MANAGING THROUGH THE CYCLE, PURDUE UNIV. 2 (Jan. 28, 2021, 10:36 AM), https://ag.purdue.edu/commercialag/Documents/Resources/Mangagement-Strategy/Busniess-Planning/2015_01_01_Gloy_Great_Margin_Squeeze.pdf [https://perma.cc/3YK6-YM2T].

As detailed more fully in Part IV of this Article, there are seven major hinges in the life of a distressed loan: (1) underwriting; (2) documenting the loan; (3) the early exit; (4) forbearance; (5) pursuing default remedies; (6) bankruptcy financing; and (7) plan confirmation. Lenders will readily recognize the importance of these events. But the problem is, at times, the hinges simply seem like another occurrence in a series of many important events.

A closely related problem is lenders frequently confuse hinge points with other key aspects of a loan. Those other key aspects are very important, but it is critical not to confuse them with a hinge. Perhaps the best illustration of this point is contrasting a hinge point with a leverage point.[15] As noted above, a hinge point is an event occurring over a relatively short period of time that has a major impact on the recovery the lender ultimately realizes on the loan. In contrast, a leverage point is a bargaining chip or weight a lender uses to persuade a borrower to make a certain choice. The most universal example of leverage is the personal guaranty.[16] However, leverage extends beyond this example. Leverage points also include: the threat to call a loan default or accelerating the balance of the loan and the threat of seeking relief from the automatic stay to liquidate the borrower's collateral.[17] A leverage point is the threat of the loss of equity due to litigation and forced liquidation of collateral. In a personal bankruptcy, a common leverage point is the threat to file a complaint based on the borrower's past wrongdoing to deny the borrower's discharge.[18] Leverage points are critically important to a lender and are generally within their control. The big challenge for the lender is knowing when and in what way to apply leverage points to help steer the borrower to the lender's desired outcome. When a lender can discern between a leverage point and a hinge point, they will be able to recognize when a hinge point occurs and will be able to maximize the outcome of that hinge point by bringing leverage to bear at the most opportune time.

In addition to leverage and the seven hinges, there are other actions a lender can take during the life of a distressed loan that will have a major impact on the

15. A loan renewal or refinancing is also not a hinge. Rather, it is a method of pushing a hinge point into the future with the hope that conditions improve.

16. *See* Jennifer Post, *The Risks Associated With a Personal Guarantee*, BUSINESS.COM (Oct. 2, 2020), https://www.business.com/articles/risks-of-personal-guarantee/ [https://perma.cc/TG28-DRKM].

17. *Chapter 11 – Bankruptcy Basics*, U.S. COURTS (Jan. 26, 2021, 11:59 AM), https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics [https://perma.cc/H45S-25F7].

18. *See id.*

ultimate recovery of the underlying debt.[19] For example, if the borrower has filed for bankruptcy, a lender may seek relief from the automatic stay of 11 U.S.C. § 362 to liquidate the collateral, or the lender may consent to the borrower/debtor's sale of the collateral free and clear of liens and encumbrances under 11 U.S.C. § 363 with the proceeds of such sale being paid to the lender.[20] While these provisions are very important to lenders, they fall outside the concept of a hinge. A lender may be able to argue either cause for stay relief exists or the debtor lacks equity in the property and it is not needed for reorganization.[21] The lender may articulate sound reasons why stay relief should be granted, but a court may reject such arguments; thereby leaving the lender in the same place as they were before the stay relief motion.[22] Thus, stay relief falls closely outside the definition of a hinge because a lender can "do everything right" with respect to it, yet such efforts may not change the trajectory of the loan if stay relief was denied. Additionally, it is the borrower—not the lender—who decides whether to sell property under § 363.[23] Thus, a § 363 sale falls closely outside the definition of a hinge because the lender never has the opportunity to make a meaningful decision with respect to the sale of the property.

The occurrence of hinge points can be pushed into the future or can be accelerated either by the lender, the borrower, or third parties. In other words, lenders do not fully control the timing of when hinge points happen. While some hinge points are very linear or sequential in nature (particularly the first and second hinges), the occurrence of other hinge points is really determined by actions the lender and the borrower take. In this regard, it is possible (albeit typically uncommon) the intervening events of a third-party creditor may force an unexpected bankruptcy filing by the borrower (effectively skipping over hinge points four and five).

Focusing on hinges is akin to focusing on the 80/20 rule.[24] If a lender wants to maximize loan recovery, then it is imperative the lender realize when a hinge

19. *See generally id.*

20. *See id.*

21. *See* 11 U.S.C. § 362(d)(1)-(2).

22. Some may argue that if a court denies a stay relief motion it actually weakens the lender because the stay relief denial removes a threat or leverage point that the creditor wielded over the borrower to try and influence behavior. *See id.* at (c)(3)(B).

23. Admittedly, if a borrower decides to sell collateral the lender does have the binary choice of determining whether or not to consent to the proposed sale. *See* 11 U.S.C. § 363(f)(2).

24. *See generally* Carla Tardi, *80-20 Rule*, INVESTOPEDIA (May 25, 2020), https://www.investopedia.com/terms/1/80-20-rule.asp [https://perma.cc/7JWU-RJJC].

point is occurring and act in a manner to maximize the hinge event. A hinge point can come and go without a lender realizing the importance of the opportunity that just passed by. If a lender does not make the most of a hinge point when one occurs, the net result is the loan process continues but it does so with the lender being in a weaker position, which adversely impacts it as future hinge points occur.

Once a lender recognizes what the key hinge points are, the next step is developing a methodology that can be employed internally to make the best decision at each point. To a certain degree, the "fine tuning" of the right methodology is very state specific.[25] For example, many states (such as Missouri) allow non-judicial foreclosure of real estate. Other states (such as Kansas) require judicial foreclosure of real estate that takes much longer.[26] Still, other states (such as Iowa) require the parties mediate before any litigation can be filed. Consequently, the degree of difficulty it takes a lender to initiate and ultimately liquidate the collateral can vary dramatically by each state. That, in turn, impacts how and when a lender will react to a deteriorating loan.

There needs to be a better, more effective approach for resolving distressed agricultural loans. In years past, attorneys generally approached a distressed debt situation with a mindset of, "Here are your legal rights and remedies. How do you want to proceed?" While that may have historically worked, a more modern approach is needed.

Over the past few decades, there have been many important academic studies relating to both human psychology and distressed debt that have shed important insight for dealing with these difficult situations.[27] Combining the work from these different fields provides a new perspective on how to resolve troubled loans more effectively. To achieve this result there needs to be a sharpened blending of professional insights to make better decisions. It is not just a matter of knowing how to pursue different remedies, rather, it is a matter of identifying what the right decision is in certain circumstances and how best to seek to implement it. How can the insights from academia be combined with the rough-and-tumble, day-to-day aspects of distressed debt resolution? The key is to develop a practical framework

25. *See* Cem Demiroglu et al., *State Foreclosure Laws and the Incidence of Mortgage Default*, 57 J.L. & ECON. 225, 230 (2014).

26. *Id.*

27. *See, e.g.*, Elizabeth Sweet et al., *The High Price of Debt: Household financial debt and its impact on mental and physical health*, SOC. SCI. MED. (May 16, 2013), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3718010/ [https://perma.cc/UZF7-FXQ8].

based on experience and add the knowledge gained from academic research to help better guide the decision-making process.

This Article is intended to produce a blend of the academic with the practical and the business with the legal. Lenders may initially view these hinges and, at first blush, think there is nothing new here. But the purpose of this Article is not to invent a new means of resolving distressed loans. Rather, the objective is to create an easily identifiable framework for resolving distressed agricultural loans and then overlay that framework with key insights from academic research. This approach enables lenders to make smarter and better decisions at each hinge point such that the ultimate outcome is much better than it would have been otherwise.[28]

This Article is divided into five parts. Part II discusses key traits of the major parties involved in a distressed agricultural loan—the lender, borrower, third-party creditors, the legal system, judges, and attorneys. Understanding these traits enables a lender to identify each party's key incentives and better predict how they will act in a given situation. Part III considers common cognitive errors that impede decisions. Recognizing the decision errors that impact each of the major parties provides further clarity on their expected choices. Part IV addresses the seven key hinge points that occur in a distressed loan: (1) underwriting; (2) documenting the loan; (3) the early exit; (4) forbearance; (5) pursuing default remedies; (6) bankruptcy financing; and (7) plan confirmation. The lender enhances the likelihood of a better outcome by recognizing when a hinge point is occurring and actively working to make the right decision at that critical juncture. Part V identifies key practices to employ at the various hinges to further enhance the likelihood of a better outcome. Finally, Part VI identifies additional areas for further research.

## II. Key Traits

Successful resolution of a troubled loan is complicated given there are typically multiple parties impacted by the outcome—each motivated by their own best interests—and the situation is continually evolving as each party acts and reacts in response to the actions of the other parties. To develop a meaningful framework/methodology for resolving troubled loans, it is first necessary to consider key traits of each major group. Understanding the fundamental characteristics of each group is critical to evaluating how a particular entity is

28. The methodology articulated in this Article assumes that the overall debt is small (less than $10 million) and that a large portion of the debt is held by a traditional lender (rather than a private entity that has loaned the money as part of a loan-to-own strategy).

likely to act in a particular situation. By better predicting the results of an outcome, a lender can develop a better strategy to maximize the recovery of the loan.

### *A. Lender Traits*

Traditional lenders tend to be remarkably similar, or as Baird and Rasmussen stated, "[b]anks are repeat players."[29] They typically have long-term relationships with borrowers and they provide various services above and beyond simply making a loan.[30] While a bank's reputation is always important, that reputation can take on added weight in a smaller market, such as a rural farming community.[31] Reputational risk can act as a restraint on the actions the lender is willing to take when the loan becomes troubled.[32]

Banks generally have well-settled practices for monitoring the borrower and confirming that the collateral securing the loan is being properly preserved.[33] Unsurprisingly, research shows that lenders deal with financial distress in different manners, including accelerating payments and waiving covenants.[34] However, lenders will rarely agree to reduce the principal balance of the loan.[35] If a loan becomes troubled, a bank is more likely to take steps within the contractual relationship (e.g., seeking additional collateral, entering into a forbearance agreement, etc.) while non-traditional lenders, such as a hedge fund, may mandate that new management be installed.[36]

It is very common for agricultural borrowers to have a primary lender that has a lien on most, if not all, of the borrower's assets.[37] This type of lender/borrower relationship has very little upside for the lender because, at most, it will obtain full payment of interest owed.[38] In contrast, the lender faces a big downside with the possible risk of losing some or all of the principal loaned.[39]

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29. Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 670 (2010).

30. *Id.*

31. *See id.*

32. *See id.*

33. *Id.*

34. Paul Asquith et al., *Anatomy of Financial Distress: An Examination of Junk Bond Issuers* 1 (Nat'l Bureau of Econ. Rsch., Working Paper No. 3942, 1991).

35. *Id.*

36. Baird & Rasmussen, *supra* note 29.

37. *Id.* at 666.

38. *Id.*

39. *See generally id.*

Because of this, when the loan becomes troubled, lenders tend to be biased towards liquidation resulting in an immediate payment of the debt.[40] In other words, lenders prefer the short term certainty of some debt repayment as opposed to an uncertain future where both principal and interest may theoretically be paid.[41] This liquidation preference carries over into bankruptcy where banks prefer liquidation and do not favor reorganization.[42]

Bankers tend to be better at evaluating financial data as opposed to evaluating borrowers themselves.[43] One study, which looked at the decisions of commercial loan officers at Swedish banks, found they had a more difficult time making decisions that required the use of "soft information" (i.e., information from client relationships) as opposed to decisions that relied on "hard information" (i.e., normal financial information).[44] This weakness in evaluating soft information is critical because it potentially leads to a host of cognitive errors (discussed in Part III below), which, in turn, may impede the effectiveness of the decisions that the bank makes with respect to the troubled loan.

### *B. Borrower Traits*

#### *1. Rational and Self-Interested*

As a general matter, borrowers are rational people who make decisions based on what they perceive is in their own best interests. As with other parties wrestling with distressed debt, a borrower will be influenced by its perceived equity in collateral, the information available to the borrower, and the borrower's own biases. While it is undoubtedly true there are very honest and very dishonest borrowers, it is the author's belief based on years of personal experience in debtor-creditor relations that most borrowers desire to comply with their contractual obligations. However, once they are unable to fulfill those obligations, the change in circumstances may lead them to take actions that are out of character or more motivated by fear than a sense of obligation.

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40. *Id.*

41. *Id.*

42. *See* Arturo Bris et al., *The Costs of Bankruptcy: Chapter 7 Cash Auctions vs. Chapter 11 Bargaining* 1 (Yale Int'l Ctr. for Fin., Working Paper No. 04-13, 2004).

43. *See* Carl-Christian Trönnberg & Sven Hemlin, *Lending Decision Making in Banks: A Critical Incident Study of Loan Officers*, 32 EUROPEAN MGMT. J. 362, 362 (2014).

44. *See generally id.*

*2. No Change in Management*

A unique feature in both agricultural and small business loans is there is unlikely to be a change in management when the loan becomes distressed. Unlike large public companies with independent boards of directors to whom management reports, agricultural operations and small businesses tend to be owned and operated by one person or a small group of people.[45] A study of large private and public Chapter 11 cases found 70% of the companies' chief executive officers had been replaced in the two-year period leading up to the filing.[46] However, that turnover in management rarely happens for smaller loans.[47] This lack of turnover typically hurts lenders as management continues its poor business practices.[48] Significantly, one study found that if a borrower's pre-petition management continued as part of the restructuring process, there was an increased probability of failure following bankruptcy.[49] Therefore, when lenders seek to resolve distressed loans it would seem incumbent that, as part of whatever restructuring occurs, management be required to adopt new and better practices designed to insure the long-term success of the company.[50]

45. *See Farmland Ownership and Tenure*, USDA (Nov. 17, 2020), https://www.ers.usda.gov/topics/farm-economy/land-use-land-value-tenure/farmland-ownership-and-tenure/ [https://perma.cc/GVS7-T8XE].

46. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 511 (2009).

47. *Id.* at 516.

48. *See* Edith S. Hotchkiss, *Postbankruptcy Performance and Management Turnover*, 50 J. FIN. ECON. 3, 4 (1995) [hereinafter *Postbankruptcy Performance and Management Turnover*].

49. *Id.* at 3-21; *see* Edith S. Hotchkiss et al., *Bankruptcy and the Resolution of Financial Distress*, *in* 2 HANDBOOK OF EMPIRICAL CORP. FIN. 235 (B. Espen Eckbo, Elsevier B.V., 2008) [hereinafter *Bankruptcy and the Resolution of Financial Distress*] (noting this is a bit dated, but detailed review of academic literature regarding bankruptcy and the resolution of financial distress. Several of the Articles cited in this Article are also considered in Chapter 14 of the Handbook).

50. In requiring that management adopt new practices, lenders need to be careful they do not cross the red line of managing the borrower or directing its affairs. Unfortunately, that line is not always easy to discern. As a practical matter, lenders could mitigate against this by conditioning their actions (or forbearance) on actions taken by the borrower (e.g., the lender can provide that if the borrower does items A, B, and C then the lender will do items X, Y, and Z). This approach is markedly different than the lender blatantly directing that the borrower must do items A, B, and C.

*3. Decisions to Pay or Not Pay Debt*

Borrowers tend to pay the creditors they need to appease for anticipated future dealings.[51] In the context of consumer debt, there is evidence that homeowners manage their housing and non-housing debt in a way that is "consistent with a rational, forward-looking, approach to credit default and to preserving access to credit."[52] As the loan-to-value ratio increases on a homeowner's residence (thereby decreasing the amount of equity), there is an increased likelihood of default.[53] But, at the same time, there is a decreased probability of default on credit card and auto debt.[54]

It has been empirically shown on home loans that the existence of a non-recourse mortgage increases the probability of mortgage default—especially if the homeowner is underwater on the mortgage.[55] If the borrower is underwater on his or her home mortgage, and the mortgage is non-recourse, then the likelihood of credit card default is 18% lower.[56] The general implication of the research is that, if the borrower recognizes they are losing the ability to borrow from one source, then they will, in turn, take steps to keep open other sources of credit from different borrowers.[57] However, this decreased amount of credit card default appears to be more transitory than permanent.[58] In the context of consumer housing loans, the evidence indicates, if there are anticipated delays in the foreclosure process (delays are common in judicial foreclosure states), the homeowner can continue living longer in the home without paying anything until the foreclosure process is completed.[59] This longer period creates a greater incentive to default on the mortgage.[60] Ironically, if there is a delay in the foreclosure process, there is a likelihood of increased credit card default.[61] Specifically, "credit card default rates are 57% higher among underwater homeowners if the expected delay in the

51. *See* Sewin Chan et al., *Determinants of Mortgage Default and Consumer Credit Use: The Effects of Foreclosure Laws and Foreclosure Delays* 1-2 (Fed. Rsrv. Bank N.Y., Staff Report No. 732, 2015).

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* at 2.

56. *Id.*

57. *See id.*

58. *Id.* at 3.

59. *Id.*

60. *Id.*

61. *Id.*

homeowners' county is at least 9 months, compared to when the delay is up to three months."[62]

Some researchers believe "[m]ortgage defaults may be driven by both strategic and liquidity considerations. Strategic considerations include a borrower's willingness to pay, which involves a comparison of the cost of continuing to make mortgage payments and the costs of default."[63] The cost of default is partly dependent upon that particular state's foreclosure laws.[64] One study reviewed defaults on consumer home mortgages and found the cost of default was approximately $30,400 in states that had a judicial foreclosure process.[65] Borrowers who have no equity in their homes appear much more likely to default on their mortgages if the state has a borrower-friendly foreclosure law.[66] Furthermore, "borrowers who are underwater and more than 60 days delinquent are significantly more likely to file for bankruptcy in non-judicial-review states and in states that permit deficiency judgments."[67]

The borrower's anticipation of what the future holds will also have a major impact on the decisions they make. In determining whether or not to default, a borrower's choice will be influenced by whether they anticipate the defaulted loan will be restructured or simply foreclosed.[68] If default on the loan is anticipated to result in foreclosure and the equity at risk is greater than the cost of keeping the loan current, then the borrower will take steps to avoid default.[69] However, if equity is sufficiently low, then default and subsequent foreclosure will likely occur.[70] In one financial model, the liquidation of an asset was likely to be avoided (1) if there was more going-concern value to the owner/manager and (2) if the market conditions were adverse to the lender such that value obtained through foreclosure and/or asset sale were low.[71]

Underinvestment or overinvestment by a borrower in their collateral is an important issue to a lender because it inherently impacts the value of the

62. *Id.*
63. Demiroglu, *supra* note 25, at 226.
64. *Id.* at 228.
65. *Id.* at 231.
66. *Id.* at 254.
67. *Id.* at 231-32.
68. David T. Brown et al., *Theory and Evidence on the Resolution of Financial Distress*, 19 REV. FIN. STUD. 1357, 1358 (2006).
69. *Id.*
70. *Id.*
71. *Id.* at 1359.

collateral.[72] There is evidence suggesting the borrower will have less of an incentive to overinvest or underinvest in collateral if they anticipate the lender will renegotiate the loan maturity date (rather than the loan payoff amount) in the event of a default.[73]

One study considered workout strategies for commercial mortgages and the probability of conditional default.[74] It found the most significant factor in the loan servicer's decision was cash flow.[75] The study also found that a borrower's default decision was determined by the amount of equity in the real estate as well as the cash flow condition of the market.[76]

Research reveals that a company's debt structure impacts how it reorganizes when it becomes financially distressed.[77] A distressed company will be less likely to liquidate its assets if it is operating in an industry that is also generally distressed and highly leveraged.[78] In short, the borrower's existing debt structure—as well as prevailing market conditions—will generally have a significant influence over what it is and is not willing to do as part of debt restructuring.

*4. The Likelihood of Bankruptcy*

A borrower's debt level, its available short-term cash, and its ability to coordinate with various creditors impacts how it will choose to restructure its debts.[79] Companies that file for Chapter 11 bankruptcy tend to have high debt, poor operating performance, and difficulty coordinating with creditors.[80] Conversely, companies that restructure outside of bankruptcy tend to have strong operating

72. *See* John P. Harding & C.F. Sirmans, *Renegotiation of Troubled Debt: The Choice Between Discounted Payoff and Maturity Extension*, 30 REAL EST. ECON. 475, 477 (2002).

73. *Id.*

74. Jun Chen & Yongheng Deng, *Commercial Mortgage Workout Strategy and Conditional Default Probability: Evidence from Special Serviced CMBS Loans*, 46 J. REAL EST. FIN. & ECON. 609, 609 (2013).

75. *Id.*

76. *Id.* at 628.

77. *See generally* Asquith et al., *supra* note 34.

78. *Id.* at 1.

79. *See* Sris Chatterjee et al., *Coercive Tender and Exchange Offers in Distressed High-yield Debt Restructurings: An Empirical Analysis*, 38 J. FIN. ECON. 333, 333 (1995).

80. *See id.*

liquidity.[81] Companies that tend to do "pre-packaged" bankruptcies have strong operating performance but also have an immediate liquidity challenge.[82]

These research findings are important for banks. While a bank does not control the borrower's decision to file for bankruptcy, the way the bank reacts to the borrower will have a major influence on whether bankruptcy is filed. For example, if the bank takes an aggressive stance and seeks to cut off all available cash, then the odds of bankruptcy or simply cessation of business operations will increase. However, if the lender takes a less aggressive approach, such as entering into a forbearance agreement or putting the loan on interest-only-status for a period of time while cash is tight, then the likelihood of a bankruptcy filing diminishes in the short term.

*5. Length of the Bankruptcy*

The size of the debtor is generally not correlated with the time it takes to emerge from bankruptcy or the amount that is distributed to creditors.[83] If a company is operating in a more profitable industry, then the duration of its Chapter 11 filing tends to be shorter.[84] In contrast, the average time to complete a Chapter 12 case (whether through discharge or dismissal of the action) has been increasing at a higher rate than cases under Chapters 11 and 13.[85] This suggests that, comparatively speaking, farmers' debt levels have been increasing more than other businesses.[86]

*6. The Cost of Financial Distress*

Financial distress can be very costly for borrowers. A study of highly leveraged transactions found that financial distress costs were estimated to be

81. *See id.* at 343.

82. *See id.* at 358.

83. Arturo Bris et al., *The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization*, 61 J. OF FIN. 1253, 1256 (2006).

84. Diane K. Denis & Kimberly J. Rodgers, *Chapter 11: Duration, Outcome and Post-Reorganization Performance,* 42 J. FIN. AND QUANTITATIVE ANALYSIS 101, 106 (2007).

85. Robert Dinterman & Ani L. Katchova, Presentation at the 2018 Agricultural & Applied Economics Association Annual Meeting: Survival Analysis of Farm Bankruptcy Filings (Aug. 5-7, 2018).

86. *Id.*

between 10% and 20% of the firm's value.[87] One study, which looked at distressed real estate, found the cost of financial distress is particularly high during times of industry downturn.[88] This leads to financially troubled companies selling assets at lower prices with less leveraged firms acquiring the assets.[89]

The cost of financial distress carries over into bankruptcy. Various studies have attempted to ascertain the cost of bankruptcy.[90] While the results vary from study to study, it is generally well accepted bankruptcy can be very costly for the borrower. One study broadly estimated the cost of bankruptcy ranges between 0% and 20% of assets.[91] Another study had tighter ranges and estimated that bankruptcy creates "administrative costs ranging between two to ten percent of" the company's estimated value.[92] Yet another publication considered several studies that estimated the costs of Chapter 11 cases and noted the average direct cost was 6.5% of the debtor's book value of assets.[93] In contrast, the estimated direct cost for a pre-packaged Chapter 11 case has been estimated to be 2.8% of the value of the borrower's assets.[94] Another study found pre-packaged bankruptcy costs to generally be in the 1.6% to 1.8% range.[95]

Finally, another study examined the costs of small-business bankruptcies from Chicago in 1998.[96] It concluded the direct and indirect costs of small-business bankruptcy cases were quite small.[97] About 60% of companies were liquidated under Chapter 7 or had their cases dismissed.[98] Half of the firms were shut down

87. Gregor Andrade & Steven N. Kaplan, *How Costly is Financial (not Economic) Distress? Evidence from Highly Leveraged Transactions that Became Distressed*, 53 J. FINANCE 1443, 1463 (1998).

88. David T. Brown, *Liquidity and Liquidation: Evidence from Real Estate Investment Trusts,* 55. J. FINANCE 469, 469 (2000).

89. *Id.*

90. *See generally* Bris et al., *supra* note 83, at 1254; Edward R. Morrison, *Bankruptcy Decisionmaking: an Empirical Study of Continuation Bias in Small-Business Bankruptcies* (Colum. L. Sch., Working Paper No. 239, 2006).

91. Bris et al., *supra* note 83, at 1254.

92. Morrison, *supra* note 90, at 2.

93. *Bankruptcy and the Resolution of Financial Distress*, *supra* note 49, at 26-27.

94. Brian L. Betker, *The Administrative Costs of Debt Restructurings: Some Recent Evidence*, 26 FIN. MGMT. 56, 66 (1997).

95. Elizabeth Tashjian et al., *An Empirical Analysis of Prepackaged Bankruptcies*, 40 J. FIN. ECON. 135, 143 (1996).

96. Morrison, *supra* note 90, at 3.

97. *Id.*

98. *Id.*

within three months and that figure climbed to 70% by five months.[99] The study concluded that bankruptcy judges played a critical role in determining whether a firm was viable or non-viable; non-viable firms were not able to pay their ongoing expenses after bankruptcy was filed.[100] In short, because small companies have simpler operations and less complicated debt structures, the likelihood of these companies being shut down in bankruptcy was more than 50%.[101] Admittedly, the generalized statistics are of little consolation to the myriad of lenders who have their own anecdotal outlier experience where the bankruptcy court allowed the insolvent company to persist in bankruptcy far too long.

#### *7. Incentives*

The foregoing research suggests that a borrower's incentives will be strongly influenced by their perceived equity in collateral.[102] These incentives, in turn, make it easier to predict how borrowers will react as the situation unfolds.[103] Equity, or lack thereof, is not the only major item the lender should consider. In loans to farmers or small businesses, lenders would also be very wise to consider what the owner's exit strategy is for a distressed loan. After all, self-preservation (either of the business itself or the owner in his personal capacity) is always a key motivating factor for borrowers. How and where does the borrower intend to survive beyond the loan? What creditors does the borrower need to appease to accomplish that? If the borrower has a viable exit strategy, then he or she may be more inclined to surrender collateral to a lender. However, if borrowers feel they have nowhere to go, then they may dig in their heels and vigorously oppose the lender at each step hoping for a miraculous resolution to the dire situation. In short, borrower incentives should be considered at each major phase of the loan. Borrowers will presumably act in their best interests and not in the lender's best interests. Accordingly, it is critical to always try and align the borrower's interests with the lender's interests.

### *C. Third-Party Creditor Traits*

The typical players in a distressed agricultural loan situation include a combination of the borrower, a primary lender, purchase money security interest equipment lenders or lessors, crop input lenders, and unsecured trade creditors.

99. *Id.*
100. *Id.* at 4-5.
101. *Id.*
102. *See generally id.*
103. *See generally id.*

Like borrowers, third-party creditors (both secured and unsecured) will act in ways that they believe will maximize their ultimate recovery. As a practical matter, this means secured creditors will seek to liquidate the collateral they hold a first priority lien in. Unsecured creditors, on the other hand, tend not to get involved in the reorganization proceeding unless they believe there is a decent likelihood that the cost of doing so will be less than the anticipated recovery.

From the main lender's perspective, third-party creditors help in the short term and can really hurt in the long term. More specifically, in the short term, third-party creditors supply badly needed equipment, supplies, services, and cash to help the borrower. However, that assistance is not free, and those same third-party creditors can become a real drain on the borrower's limited cash as time passes.[104] Indeed, this reality is illustrated by one study that found as the number of secured creditors increases, the unsecured creditors will recover less through bankruptcy.[105]

Subordinate lienholders can be particularly difficult for primary secured lenders. Skilled attorneys know how to create chaos and leverage key facts to extract settlement value for their clients. Subordinate lienholders may try to leverage their positions to extract concessions from the senior lienholder.[106] As the borrower's debt becomes less concentrated with a senior secured lender, the problem of a holdout creditor becomes more severe.[107] For example, subordinate lienholders may take an obstructionist approach by contesting legal proceedings and attempting to introduce uncertainty into the liquidation proceeds as a means of extracting concessions.[108] Stated differently, second lienholders may resist or obstruct proceedings simply to send a message they will be financial holdouts unless they get paid. Subordinate lienholders accomplish this by challenging perfection issues on the senior lienholder's documents.[109] They can assert opposing legal theories which, while weak, still pass Rule 11 muster.[110] The thought of

104. Bris et al., *supra* note 42, at 1.

105. *Id.*

106. *See* Russell Huebsch, *What Is a Subordinate Lien Holder?*, POCKETSENSE (May 8, 2019), https://pocketsense.com/subordinate-lien-holder-12124517.html [https://perma.cc/HR8E-FGTN].

107. Stuart C. Gilson et al., *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315, 339 (1990).

108. *Id.* at 321.

109. Robert L. Cunningham & Yair Y. Galil, *Lien Subordination and Intercreditor Agreements*, 25 THE REV. OF BANKING & FIN. SERV. 49, 53 (2009).

110. *See id.*

incurring extensive attorney fees over an extended period can induce parties to come to the settlement table where resolutions are reached.

Based upon this author's experience, disputes between a primary secured lender and individual purchase money security interest lenders do not happen frequently. Rather, problems tend to arise when there is a dispute with a subordinate lienholder in key property, or as noted in a recent article, "second mortgage debt is a clear harbinger of increased risk of default . . ."[111] Freyermuth and Whitman have observed that

> [s]econd mortgage debt has a further negative impact that other types of debt do not; it decreases the borrower's equity in the property, giving the borrower less to protect and less to lose in a subsequent foreclosure. Thus, the borrower's incentive to avoid default on the first mortgage is weakened by junior mortgage financing.[112]

Additionally, senior lenders may have an incentive to push for liquidation of the collateral while subordinate creditors, who are in the "first loss" position, may have an incentive to push for a workout.[113] Notably, the probability of a private workout is increased if the company has fewer distinct debt classes and a larger percentage of the company's debt is long term bank debt.[114] In contrast, companies that file for Chapter 11 bankruptcy tend to have high debt, poor operating performance, and difficulty coordinating with creditors.[115]

### *D. Legal System Traits*

The legal system has certain traits that need to be considered as lenders contemplate their options for resolving a distressed loan. To begin, the judicial process is antithetical to today's "get-it-done-now" business environment. Due process mandates that litigants be given notice of disputes and reasonable periods of time to contest them.[116] Additionally, many courts struggle with large dockets, further diluting judicial time and attention that can be focused on particular

111. R. Wilson Freyermuth & Dale A. Whitman, *Residential Mortgage Default and the Constraints of Junior Liens*, 57 U. LOUISVILLE L. REV. 207, 209 (2019).

112. *Id.* at 210.

113. DOUGLAS E. LAHAMMER & DANIEL B. GUGGENHEIM, REAL EST. L. & INDUS., IMPORTANT ISSUES IN PURCHASING AND RESOLVING DISTRESSED REAL ESTATE DEBT 8 (2009).

114. Gilson et al., *supra* note 107, at 316.

115. *See* Chatterjee et al., *supra* note 79, at 341-43.

116. U.S. CONST. amend. V.

results.[117] While existing statutes and past case law provide adequate guideposts for anticipating how a particular court may rule in a particular case, judicial rulings can never be 100% accurately predicted, particularly given the reality that a judge may not see it your way even when you believe that the law, facts, or both are on your side.[118] Indeed, judges are human and they, too, make mistakes.[119] For example, one study found that judges tend to be just as susceptible to anchoring bias, hindsight bias, and egocentric bias as other decisionmakers.[120] Those biases are discussed in Part III.

Litigators learn early in their careers the myriad of ways complications can be introduced into a legal proceeding, thereby causing what some would consider to be simple cases to languish on dockets far longer than necessary.[121] Even with the different alternative fee arrangements that exist, parties typically underestimate the amount of attorneys' fees that will ultimately be incurred during a legal proceeding. A good rule of thumb is the longer a legal proceeding continues, the more the parties' respective attorneys' fees will be.

Bankruptcy also has its additional set of challenges. The Bankruptcy Code is structurally biased in favor of debtors.[122] With the exception of over-secured creditors who are entitled to recover both interest and attorneys' fees and costs,[123] the time value of money does not play any role in the pre-confirmation period, nor

117. Harry C. Westover, *The Cause, Effect and Solution of Congestion in the Federal Courts*, 10 HASTINGS L.J. 384, 385 (1959).

118. As a practical matter, lenders can best prepare for legal proceedings by properly and thoroughly documenting a borrower's defaults and non-compliance with its loan obligations. Lenders need to realize they must paint a compelling picture based on admissible facts for the judge—particularly if there has been fraud or collateral conversion. The challenge, of course, is that front line loan officers are not well versed in evidence and frequently have strong or well-founded suspicions of borrower wrong doing but lack sufficient concrete evidence to demonstrate that to the court. Consequently, lenders who truly want to "elevate their game" when it comes to resolving distressed loans would be wise to establish a tighter working relationship between loan officers and attorneys so adequate evidence can be generated. *See* David J. Celuch, *Why do judges make mistakes?*, OR. DEF. LAW. (Sept. 7, 2018), https://www.djccriminaldefense.com/blog/2018/09/why-do-judges-make-mistakes/ [https://perma.cc/X68D-6KXK].

119. *Id.*

120. Chris Guthrie et al., I*nside the Judicial Mind*, 86 Cornell L. Rev. 777, 816 (2001).

121. *See How Delays in the Process Work Against Plaintiffs*, HANDLER HENNING & ROSENBERG, (Apr. 12, 2018), https://www.hhrlaw.com/blog/2018/april/how-delays-in-the-process-work-against-plaintiff/ [https://perma.cc/C47C-896N].

122. Theodore Eisenberg & Stefan Sundgren, *Is Chapter 11 Too Favorable to Debtors? Evidence from Abroad*, 82 CORNELL L. REV. 1532, 1533 (1997).

123. 11 U.S.C. § 506(b).

is there any interest awarded for the payment of unsecured claims as part of a reorganization plan.[124] A bankruptcy judge is also not penalized if the judge continues a matter for several months—even if that continuation results in significant fees for all parties.[125] Indeed, sometimes it is just easier for judges to "kick the can down the road" as opposed to making a tough decision.

Many of the characteristics impacting traditional litigation also carry over into a bankruptcy proceeding. Generally, a fast bankruptcy is better than a long one. Not only will attorneys' fees be smaller in a fast bankruptcy, but frequently a fast bankruptcy yields a more definitive result—i.e., the court dismisses the case because it is clear the debtor should not or cannot be in bankruptcy, or a consensus is reached on a plan that is quickly confirmed. In contrast, a long bankruptcy proceeding may be indicative that either (a) the debtor is unable to obtain a consensus with its various creditor classes on a viable plan (or maybe the debtor does not have one or cannot feasibly confirm one) or (b) the debtor is artfully using various legal maneuvers to stall plan confirmation simply to delay the timing of payments to creditors.

Legal proceedings are not all doom and gloom. Sometimes a lengthy legal proceeding is needed to force a party to give in and finally come to the bargaining table when it has taken an unreasonable settlement position. Additionally, there are certainly times when parties simply are at an impasse and need a court to rule on their dispute. Those situations tend to involve legal disputes rather than factual disputes.

### *E. Bankruptcy Judge Traits*

Given the structural bias of the Bankruptcy Code, most bankruptcy judges will give debtors some slack as they seek to reorganize their financial affairs.[126] However, judges are not created equally. The particular judge assigned to a case makes a difference on how key motions (such as dismissal of the case, use of cash collateral, stay relief, etc.) are determined.[127] The particular judge assigned to the

124. Thomas O. Kelly III, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 UNIV. CHI. L. REV. 305, 316 (1983).

125. *See* Benjamin Weiser, *Judge's Decisions Are Conspicuously Late*, N.Y. TIMES (Dec. 6, 2004), https://www.nytimes.com/2004/12/06/nyregion/judges-decisions-are-conspicuously-late.html?auth=login-facebook [https://perma.cc/5SPR-HYBX].

126. *See* Eisenberg & Sundgren, *supra* note 122, at 1533.

127. Tom Chang & Antoinette Schoar, *Judge Specific Differences in Chapter 11 and Firm Outcomes* (AFA 2007 Chi. Meetings Paper, Mar. 14, 2006) (on file with MIT Sloan Sch. of Mgmt.).

case also impacts the amount of time a case stays in bankruptcy.[128] One study found some bankruptcy judges tend to consistently rule more favorably for creditors while others tend to rule in favor of debtors.[129] The disposition of a judge—whether toward creditors or debtors—makes a difference in how well the company fares after bankruptcy.[130] One study found "that increasing the debtor friendliness of the distress resolution environment leads to an *increase* in firm shut downs and lower sales and employment growth coming out of Chapter 11."[131] These results intuitively make sense. A debtor-friendly judge is more likely to confirm a plan of an inefficient debtor when the judge can reasonably see the fundamental problems of the company. Unfortunately, lenders do not have the ability to determine which bankruptcy judge is assigned to a particular case.[132] Once a judge is assigned, the lender can begin to develop an effective strategy for trying to make the most of a bad situation.[133]

### *F. Attorney Traits*

Just like the other major players involved in distressed debt resolution, attorneys bring both strengths and weaknesses to the table. To begin, a highly skilled attorney can really make a difference.[134] One study, which looked at attorneys practicing before the United States Supreme Court, found the lawyers with more experience before the Court tended to obtain better outcomes.[135] Conversely, an inexperienced attorney may recognize the parties' various legal rights but nonetheless provide sub-optimal representation because the attorney does not fully grasp nor address the critical undercurrents of the situation.[136]

128. Bris et al., *supra* note 83, at 1254.

129. Tom Chang & Antoinette Schoar, *Judge Specific Differences in Chapter 11 and Firm Outcomes* 2 (Jan. 8, 2013), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.718.2996&rep=rep1&type=pdf [https://perma.cc/ZFB3-2XJW].

130. *Id.* at 3.

131. *Id.*

132. *See id.*

133. *See id.*

134. Michael J. Nelson & Lee Epstein, Lawyers with More Experience Obtain Better Outcomes 7 (Working Paper, May 14, 2019) (on file with author).

135. *Id.*

136. *See* Brian Grossman, *Young and in Law: How Being A Young Attorney Has Its Advantages and Disadvantages*, ABOVE THE LAW (May 19, 2017), https://abovethelaw.com/2017/05/young-and-in-law-how-being-a-young-attorney-has-its-advantages-and-disadvantages/ [https://perma.cc/NL3C-R8MN].

Further impacts on the situation are the biases, attitudes, and financial incentives an attorney brings to the situation. Attorneys tend to be over confident in their positions and anticipated outcomes while simultaneously underestimating the fees that will be incurred during the litigation.[137] Some attorneys bring a bulldog mentality to the litigation, which, although necessary at times, frequently results in substantially higher attorneys' fees and costs for all parties.[138] A good attorney will not be drawn into the emotion of the situation, but rather will maintain objectivity and work to accomplish the client's goals even when doing so is not in the attorney's best interests.

## III. AVOIDING DECISION ERRORS

As detailed in Part IV, there are several key junctures, or hinges, lenders face with distressed agricultural loans where the lender's actions (or inactions) can have a dramatic impact in the lender's ultimate collection of the loan. Because these hinge points frequently arise in complex situations, it is essential that the lender make the best decision possible to maximize the likelihood of a good outcome. To make good decisions, lenders need to be aware of common decision errors or cognitive biases that hinder sound decision-making. Understanding common decision biases is critical because they influence the decisions of lenders, borrowers, other creditors, attorneys, and judges. Considering the academic research in this field will help guide lenders to make better decisions (or influence the results that they want) when they arrive at the hinge points in distressed loans.

### *A. Anchoring Bias*

An anchoring bias occurs when one becomes too fixated on an initial evaluation, resulting in a failure to make sufficient adjustments to newer estimates

137. Laura Rico, *Lawyers tend to be overconfident, study finds*, UCI NEWS (May 11, 2010), https://news.uci.edu/2010/05/11/lawyers-tend-to-be-overconfident-study-finds/#:~:text=Study%20co%2Dauthored%20by%20UCI's,overly%20optimistic%20about%20case%20outcomes.&text=Lawyers%20often%20overestimate%20their%20chances,and%20law%20professor%20Elizabeth%20Loftus [https://perma.cc/CT6J-CHYH].

138. A prime example of this is billable hour litigation. An attorney with associates working under him or her can generate a substantial amount of billable hours in a contentious and protracted litigation, which typically results in financial rewards from the firm. But if a case is settled, the attorney will not generate the revenue for the firm. Truly great attorneys can see when a client is better off through settlement rather than extended litigation and the attorney will zealously work to achieve that goal even though it may not result in a large number of billable hours. Doug Chagian, *Litigation Strategies Part III: Bulldog Lawyers*, MIELDERLAW.COM (Dec. 20, 2012), https://mielderlaw.com/plan-to-be-100/litigation-strategies-part-iii-bulldog-lawyers/ [https://perma.cc/PAJ7-NKUR].

as additional information becomes available.[139] One practical problem with anchors is that even if they do not provide the actual value of an item, they will still influence the person's judgment.[140] Initial anchors can be difficult to overcome.[141] Even after people determine that an anchor does not provide useful information, people still tend to adjust their estimates toward the anchor, which means that even odd or extreme anchors can impact judgment.[142]

How a lender initially values collateral can create an anchoring bias for the remainder of the loan workout process.[143] The lender's initial anchor will dramatically impact the strategy taken in seeking to resolve the distressed loan.[144] Anchors influence settlement discussions with opening offers anchoring participants' expectations and impacting the settlement preferences.[145] Anchors also impact how the lender ultimately interprets the outcome of the resolution.[146] If a lender values the collateral too high or if the lender does not fully consider the costs needed to liquidate the collateral, then the ultimate outcome will be very disappointing and will shape how the lender perceives and reacts to the next troubled loan situation that comes along.

An anchoring bias can also have a significant impact on how borrowers proceed in resolving a troubled loan. If the borrower does his or her initial anchoring at a high value, such that the borrower believes there is equity in the collateral, then that will incentivize them to act in a way to protect and preserve the perceived equity.[147] It is important to remember in the context of inherited agricultural land, the "equity" may not be limited to the net value of the real estate, but it can also include the strong emotional attachment associated with the land and the corresponding sense of identity the borrower may derive from it. Conversely, if the borrower believes there is little-to-no equity in the collateral, then they will have less of an incentive to preserve it and a greater incentive to preserve other business relationships they perceive essential to their future needs.[148] Given this reality, an important initial question for lenders to explore is

139. Lovallo & Sibony, *supra* note 1.
140. Guthrie et al., *supra* note 120, at 788.
141. *Id.*
142. *Id.*
143. *See id.*
144. *See id.*
145. *Id.*
146. *Id.* at 789.
147. *See id.* at 788
148. *See id.*

what do their borrowers genuinely think the collateral is worth? Do they believe they have equity in the collateral? The accuracy of their answer is less important than what they believe or think the collateral's value is because it is the borrower's belief or perception that will strongly influence the actions they take.[149] In short, the key takeaway is that the initial position that either the lender, the borrower, or even a third-party creditor take regarding collateral valuation will inevitably create an anchor[150] that will significantly influence distressed-debt resolution efforts.

### *B. Framing Bias*

As people confront risky decisions, they tend to categorize their different options as either possible gains or losses as compared to the status quo.[151] This framing (or categorization) of the different choices influences the path they ultimately take.[152] Guthrie, Rachlinski, and Wistrich have observed that "[p]eople tend to make risk-averse decisions when choosing between options that appear to represent gains and risk-seeking decisions when choosing between options that appear to represent losses."[153] Perhaps the most commonly cited illustration of this concept is the fact people generally prefer getting $100 over a 50% chance of obtaining $200, but they would prefer a 50% chance of losing $200 rather than incurring a $100 certain loss.[154] Succinctly stated, "people make choices designed to maintain or slightly improve the status quo, which translates into risk-averse choices for most gains and risk-seeking choices for most losses."[155]

The framing bias tends to impact parties depending on whether they are the plaintiff or the defendant in a lawsuit. It has been suggested plaintiffs tend to be more inclined to settle than defendants because of the different way they frame their decision options.[156] "[P]laintiffs often choose between options that appear to represent gains, while defendants often choose between options that appear to represent losses. As such, plaintiffs are more likely to prefer settlement, the risk-averse option, while defendants are more likely to prefer trial, the risk-seeking option."[157]

149. *See id.*
150. *See id.* at 788-89.
151. *Id.* at 794.
152. *See id.*
153. *Id.*
154. *Id.*; *see also* Amos Tversky & Danil Kahneman, *Advances in Prospect Theory: Cumulative Representation of Uncertainty*, 5 J. RISK & UNCERTAINTY 297, 308 (1992).
155. Guthrie et al., *supra* note 120, at 795.
156. *Id.* at 796.
157. *Id.* at 795.

The framing bias impacts how the lender perceives the borrower, and vice versa. Similar to the plaintiff versus defendant paradigm, lenders and borrowers are placed in comparable positions. As a result, it is unsurprising lenders are biased toward the immediate sure thing (i.e., liquidation of the collateral and payment of the debt), while borrowers prefer the riskier option of continuing business operations with the hope things will work out.[158] If the borrower's financial condition continues to deteriorate, the framing bias continues to push lenders toward liquidation, while the borrower's framing bias induces them to seek the risky option of bankruptcy, for they get a temporary breathing spell from creditors but the likelihood of a successful plan confirmation is far from certain.[159]

### *C. Representative Bias*

Representative bias can occur when a person places too much weight on a particular subset of data or wrongly interprets the significance of the data.[160] Statistically speaking, it is common sense that one needs to have sufficient sample size to accurately interpret the data. Conversely, if the sample size is too small, then there is a risk the particular sample is an outlier and not truly indicative of objective facts. If people rely too much on the representative bias it can result in them making a host of decision errors.[161]

A practical problem with representative bias is that it can cause a person to discount information that is statistically relevant.[162] Stated differently, when base rate or background information is available, representative bias may cause people to ignore or discount it as they make a categorical judgment.[163] It has been suggested that one reason people tend to discount relevant statistical information—and put more weight on the categorical evidence before them—is because the latter is more vivid and salient.[164]

The representative bias is not just limited to statistical data. When a person makes a categorical judgment about something—such as evaluating whether a producer is a good farmer or a poor farmer—they tend to base their judgment on

158. *See* Baird & Rasmussen, *supra* note 29, at 666.
159. *See id.*
160. *See* Guthrie et al., *supra* note 120, at 805.
161. *See id.* at 805-06.
162. *Id.* at 805.
163. *See id.*
164. *See id.* at 806.

which amongst the facts being considered are representative of the category.[165] If the facts being analyzed are congruous with the category being considered, then "people judge the likelihood that the evidence is a product of that category as high."[166] But if the facts being analyzed are incongruous with the category being analyzed, then "people judge the likelihood that the evidence is a product of that category as low."[167]

One of the most common situations where a lender may get tripped up by representative bias is when evaluating the soft data learned from an on-site visit.[168] For example, imagine a scenario where a lender is determining whether a row crop producer is a good farmer or a bad farmer. If an on-site inspection shows the workshop area for the farm is generally neat and clean, then the lender may conclude the row crop producer is a good farmer. But if the workshop area is messy and disorganized, then the lender may conclude the producer is not a good farmer. The problem, of course, is that the condition of the workshop area may not be representative of the row crop producer's abilities.[169]

It has been noted that "Western culture individuals typically choose to explain events in terms of people's actions and traits rather than situational factors."[170] If this is true, such thinking allows the particular borrower to become the scapegoat for the distressed loan a lender is facing when, in reality, the distressed loan could be the product of the overall situation rather than the borrower's character.

### *D. Confirmation Bias*

Confirmation bias has been described as the "overweighting of evidence consistent with a favored belief, underweighting of evidence against a favored belief, or failure to search impartially for evidence."[171] Stated differently, confirmation bias occurs when we focus on facts that buttress our belief, desired choice, or outcome while simultaneously ignoring other evidence that cuts against

165. *See id.* at 805.
166. *Id.*
167. *Id.*
168. *See* Trönnberg & Hemlin, *supra* note 43, at 369.
169. *See* Guthrie et al., *supra* note 120, at 805.
170. Chip Heath et al., *Cognitive Repairs: How Organizational Practices Can Compensate for Individual Shortcomings*, 20 RSCH. IN ORGANIZATIONAL BEHAV. 1, 7 (1998).
171. Lovallo & Sibony, *supra* note 1, at 16.

that choice or outcome.[172] Confirmation bias is closely related to the representative bias, and is particularly dangerous when a person enters a situation with a preconceived idea regarding what ultimate outcome they desire.[173]

For example, a loan officer may want to renew a loan rather than have it sent to collection because the renewal could have any of the following results: a small monetary remuneration; preserving an existing relationship with the borrower; or avoiding the internal embarrassment the loan officer may feel if the loan is reclassified as distressed. With these results in mind, when the loan officer visits on-site, he or she may be particularly focused on any soft data they can report that suggests things are turning around.[174] Conversely, the loan officer may ignore or discount soft data that suggests there are truly problems with the loan.

The confirmation bias is inevitably rooted in emotion. People want particular outcomes, and they feel good when those outcomes occur and bad when they are not realized.[175] Consequently, overcoming the confirmation bias necessitates a more systematic reporting of all the evidence, and establishing a process where it may be more objectively evaluated without the bias of a particular desired outcome.[176]

### *E. Egocentric Bias*

Egocentric bias occurs when a person makes a judgment about themselves or their abilities that is self-serving.[177] If we are honest with ourselves, we realize that all of us suffer from egocentric bias to one degree or another. Egocentric bias occurs for multiple reasons including self-presentation, mental searches for confirmatory information, and the fact that each person remembers their own actions better than another's actions.[178]

One study found investment bankers are strongly influenced by their overconfidence particularly in valuation and investment choices.[179] Lawyers and their clients are also afflicted by egocentric bias when they overestimate their

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172. *See id.*
173. *See* Guthrie et al., *supra* note 120, at 805.
174. *See generally* Lovallo & Sibony, *supra* note 1, at 16.
175. *See* Guthrie et al., *supra* note 120, at 812.
176. *See* Lovallo & Sibony, *supra* note 1, at 16.
177. *See* Guthrie et al., *supra* note 120, at 811.
178. *See id.* at 812.
179. *See* Jérôme Lambert et al., *Does Expertise Influence the Impact of Overconfidence on Judgment, Valuation and Investment Decision*, 33 J. ECON. PSYCH. 1115, 1116 (2012).

abilities and the strength of their case.[180] The egocentric bias of parties and their attorneys can, in turn, undermine settlement efforts.[181] In litigation, plaintiffs will tend to value the likely judicial outcome to be higher than what defendants will typically assess.[182]

In distressed loan scenarios, lenders will frequently (a) want their collateral liquidated as soon as possible to pay down outstanding debt, and (b) are not concerned about what happens to the borrower after the debt has been repaid. This mindset exhibits the egocentric bias that may result in three related problems. First, it assumes that the borrower will act in a manner wholly consistent with the underlying loan agreements and the lender's wishes. Second, it ignores the fact the borrower will act in a manner the borrower believes will best serve its long term interests. Third, it also ignores the fact that, if the relationship with the borrower is acrimonious, the borrower may act in a manner that increases the lender's costs of collection or reduces the amount of recovery the lender ultimately realizes on the collateral.

As a practical matter, an initial key to overcoming the egocentric bias is to recognize that it exists. As parties then begin to make predictions about the future (i.e., the cost of the litigation, the time requirement of the litigation, how the opposing party is expected to react, etc.) it is critical that the decisionmakers determine what factors are being considered in making the predictions and whether any additional information could be gathered to make the "forecast" more accurate. Another key is to have someone else critically challenge the prediction. What errors do they see? What is being overlooked? In effect, taking the prediction and putting it through the "refining fire" of a robust review process will help ferret out the egocentric bias and yield a more accurate and refined prediction of anticipated future events.

### *F. Hindsight Bias*

Hindsight bias is the tendency for people to overestimate how predictable past events were.[183] Hindsight bias results when people use their experiences of past events to inform their beliefs about the world, and then rely on those beliefs to estimate what is predictable, but in doing so they ignore the fact that learning

180. Guthrie et al., *supra* note 120, at 812-13.
181. *Id.* at 813.
182. *See id.* at 813.
183. *Id.* at 799.

the new facts has changed their mindset.[184] One reason why hindsight bias may be so common is because people tend to think in self-serving ways that make them feel good about themselves.[185] Experience can reduce—but does not eliminate—hindsight bias.[186] Unfortunately, judges are susceptible to hindsight bias because they tend to evaluate events after they have occurred.[187]

Hindsight bias can become closely intertwined with representative bias and egocentric bias.[188] The combination of these biases can play a decisive role in the resolution of distressed agricultural loans.[189] For example, a lender will have some dealings with the borrower early in the distressed loan process. Based on the results of those initial dealings, the lender will develop beliefs and perceptions about the borrower, such as anticipating how the borrower will behave as the situation develops. In learning such information, the lender fails to recognize how the acquisition of new information will shape how they will react to future events.[190] When confronted with a decision at the next phase of the distressed loan, the lender may fall prey to representative bias (believing they have properly obtained accurate information) and egocentric bias (believing they can accurately predict the future), and they will then make key decisions on how to proceed.[191] If the decision turns out well, the lender will congratulate their self on their astuteness to accurately predict the future.[192] But if the decision turns out poorly, the lender may seek to discount the result (representative bias) by suggesting certain facts were not quite so readily apparent.

With the lessons learned from the first distressed loan, the lender will then move to the next distressed loan with new preconceived perceptions of the past results, which will be considered in resolution of the new distressed loan.[193] If the lender fails to recognize they have fallen prey to various biases, then their ability to properly evaluate and interpret new events will be hindered.[194] In effect, the cycle of decision-making errors will continue because the lender is not aware such

184. *See id.*
185. *See* Heath et al., *supra* note 170, at 6.
186. Guthrie et al., *supra* note 120, at 801.
187. *See id.* at 800.
188. *See id.* at 784.
189. *See generally* Lovallo & Sibony, *supra* note 1.
190. *See* Guthrie et al., *supra* note 120, at 799.
191. *See id.* at 784.
192. *See* Heath et al., *supra* note 170, at 6.
193. *See* Guthrie et al., *supra* note 120, at 802-03.
194. *See id.* at 799.

errors are occurring. If the lender recognizes the errors are occurring, then they can fix the process, such that more methodical learning can occur, and this will hone and improve their decision-making ability for the next distressed loan.

### *G. Other Biases*

There are additional cognitive biases that can impair the process of making sound decisions. These include: action-oriented biases (i.e., excessive optimism); interest biases (i.e., misaligned individual and corporate goals, incentives, or inappropriate attachments); pattern recognition biases (i.e., improper reliance on certain successes or improper analogies[195]); stability biases (i.e., loss aversion, failing to recognize sunk costs, or a focus on maintaining the status quo); and social biases (i.e., groupthink or "sunflower management" where groups seek to align the decision with the leader's view).[196] Each of these biases can adversely impact sound decision-making.[197] Given the amount of money at stake with agricultural loans, lenders would be wise to seriously consider what biases exist in their key decision-making processes. By recognizing and addressing those biases, lenders will improve the quality of their decisions and, in turn, will improve their desired outcomes over time.[198]

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195. A common example of improper analogies is the excessive reference to sports analogies when seeking to resolve complex legal or business decisions. The problem with the use of sports analogies is that sports, by their nature, are well-defined with very clear rules, provide an even playing field, and the winners and losers are always easy to identify. Sports analogies also lead people to improperly conclude that if they "play tough" they can push through the challenge to get their desired result. Another problem is people tend to think their very complex and difficult problem can be resolved by some small and specific actions. They then think that if they just do a couple of small things their problems will be magically resolved. But these analogies frequently miss the mark (the author recognizes the hypocrisy of using this bow and arrow analogy). Complex legal and business decisions are frequently antithetical to a sports environment. Complex legal and business decisions typically involve multiple related parties with differing interests. There is no clear "playing field," and determining who is a "winner" or "loser" is involves a very subjective analysis based on the values held by the different parties.

196. *See* Lovallo & Sibony, *supra* note 1, at 15-16.

197. The author has personally observed many instances over the years where the leader of a group is very dominant in their views. They frequently believe they best understand the situation (egocentric bias), often focuses on data aligning with their desires (confirmation bias) and ignore or discount other information that suggests they are wrong (representative bias). Dominant group leaders tend to be smart, charismatic, and strong-willed, which makes it more difficult for group members to challenge the leader. As a practical matter, anytime a particular group or organization is led by a very dominant leader, it should be a red flag that the decisions coming from the group or organization may not be optimal. *See id.* at 15.

198. *See id.*

## IV. LENDER HINGE POINTS

As explained above, a hinge point is an event that occurs over a relatively short period of time and has a major impact on the recovery that the lender ultimately realizes on the loan. To maximize loan recovery, it is essential a lender (a) identify when a hinge point is occurring, and (b) act in a manner that maximizes the likelihood of loan recovery. There are at least seven key hinge points in the life of a distressed loan.[199] They are:

Hinge 1: Underwriting

Hinge 2: Documenting the Loan

Hinge 3: The Early Exit

Hinge 4: Forbearance

Hinge 5: Pursuing Default Remedies

Hinge 6: Bankruptcy Financing

Hinge 7: Bankruptcy Plan Confirmation

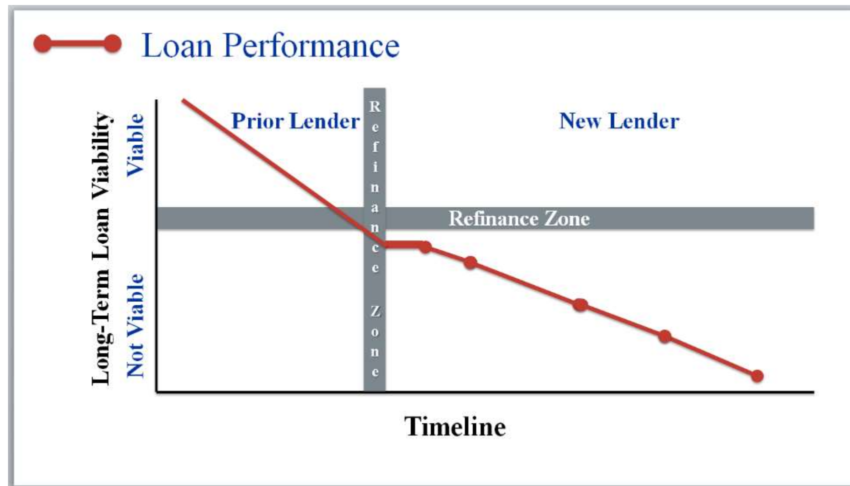
Focusing on hinge points is akin to the 80/20 rule—there is an oversized outcome based on the decisions and actions that a lender takes at each hinge. [200] In

199. Some may suggest that there are additional hinge points, such as relief from the automatic stay under 11 U.S.C § 362 or a sale of the lender's collateral pursuant to 11 U.S.C § 363. There is some merit to these arguments. Stay relief motions typically occur shortly after a bankruptcy is filed or sometime prior to plan confirmation. Stay relief has an oversized outcome on the loan recovery, because, if the stay relief is granted, the lender can proceed to liquidate the collateral without the debtor invoking further bankruptcy protection. But the problem with a stay relief motion is that a lender can "do everything right" and still have the motion denied; thus, leaving it in the same position as before. Therefore, it falls closely outside the definition of a hinge. In a § 363 sale the debtor proceeds to sell the collateral free and clear of assets with the lender's lien attaching to the collateral proceeds. But it is the debtor—not the lender—who makes the decision whether or not to sell and at most the lender can simply try to influence that decision. Both stay relief and § 363 sales result in an immediate liquidation of the underlying collateral thereby causing a loan paydown. Truly these provisions are very important to lenders. Notwithstanding this, however, they have been omitted from the list of hinge points because they fall outside the definition of a hinge.

200. *See* Tardi, *supra* note 24.

effect, the better each decision is at each hinge point, the better positioned the lender will be with respect to recovering the loan.

The following chart helps illustrate the seven hinge points in action.




The Y-axis is the level of the loan's long term viability which is split in two parts—viable and not viable. Loans that are above the "refinance zone" are considered long term viable loans given traditional lending standards and measures. Loans that fall below the refinance zone are those that are considered distressed and are very difficult to refinance in normal lending conditions. The refinance zone identifies the period where a loan is declining in performance but is still marginally acceptable such that a traditional lender may make a gamble on it hoping it will perform.

The X-axis represents time with each hinge point sequentially placed. The "loan performance" line identifies where the viability of the loan is at any given point in time. The loan performance line is flat between hinges 1 and 2 because they occur almost simultaneously. There are some hinges where there is a dotted line with a slightly upward trajectory. The dotted line represents the anticipated outcome if the lender maximizes its decisions at that particular hinge point. For example, if the lender makes smart moves at hinge 4 (underwriting), the loan could return to viability in a relatively short amount of time and the lender would be better off as a result. But, if the lender misses their opportunity at hinge 4 and the loan deteriorates to hinges 5 or 6, the graph indicates the lender will be worse off. However, smart moves at hinge 6 would enable the loan performance to begin to

improve. This will put the lender in a better position as opposed to what would occur if it had failed to make the right moves at that hinge.

It is also important to note that not all loan situations represent the clean depiction represented in this graph. For example, a loan could be at hinge 3 but then an unexpected and catastrophic market shock could occur (such as COVID-19), which suddenly puts the borrower and lender into a hinge 6 decision situation. Alternatively, it is possible a lender may be implementing a forbearance with the borrower (hinge 4), and unexpected actions by other creditors could occur, which again puts both parties into the hinge 6 area.

### *A. Hinge 1: Underwriting*

Underwriting is the first hinge a lender encounters in a distressed loan. The central question at hinge 1 is whether the lender will make the loan. Some may argue that this is a decision the lender always gets wrong with respect to a distressed loan because if the loan underwriting were done properly in the first place, the loan never would have been made.[201] Such arguments, however, suffer from hindsight bias and do not provide any meaningful guidance for the lender when it is faced with the prospect of executing a newly proposed loan. The reality of the matter is virtually all loans—both the majority that turn out good and the minority that turn out bad— passed underwriting standards initially. The more fundamental question is whether there were any red flags that should have been spotted during the underwriting phase that were either ignored (confirmation bias) or simply missed altogether.

While a full analysis of proper standards in loan underwriting is beyond the scope of this Article—and beyond the scope of this author's expertise—there are some observations that should be noted. First, because farming is frequently a family endeavor, it is very common to have loans where multiple family members (husband, wife, parents, siblings, etc.) are borrowers or guarantors. Additionally, despite the personal risks involved, it is also somewhat common to see farming operations operated via general partnerships.[202] Understanding the structure of the

201. *See generally* THE DETECTION AND DETERRENCE OF MORTGAGE FRAUD AGAINST FINANCIAL INSTITUTIONS: A WHITE PAPER, FFIEC FRAUD INVESTIGATIONS SYMPOSIUM *5* (July 2009), https://www.ffiec.gov/exam/Mtg_Fraud_wp_Feb2010.pdf [https://perma.cc/U9JZ-FPM3].

202. *See* Jaqui Brauman, *Farm Business Succession*, LAWADVISOR (Mar. 15, 2021, 1:23 P.M.), https://www.lawadvisor.com/articles/farm-business-succession [https://perma.cc/YPW7-BLUS].

farming operation is critical, for it ultimately determines who will be liable for the loan and who will have a vested interest to see that it succeeds.

Second, given how loosely agricultural borrowers tend to follow corporate formalities, it is imperative the lender thoroughly document which entity owns which collateral. If family farming operations are so integrated that equipment ownership is opaque, then a prudent lender should get a signed statement from the closely related party expressly disclaiming any ownership interest in the collateral. Doing so can save the lender a big headache if the loan moves into the collateral liquidation phase.

Third, it is absolutely critical in the underwriting process to really think through the borrower's existing and anticipated future debt structures.[203] Third-party creditors can have a major impact on the ability to collect on an outstanding loan. [204] Third-party creditors can also heavily influence the borrower's incentives as the loan becomes distressed.[205] Thinking through the outcomes of potential worst-case scenarios will better help the lender spot possible red flags.

Fourth, state laws about judicial foreclosure versus non-judicial foreclosure make a difference for distressed loans.[206] There is evidence that lenders in judicial foreclosure states take a more conservative approach when evaluating loan applications of borrowers.[207] However, as competition becomes more intense, there is a temptation to lower loan standards with the hope of obtaining the loan.[208] But this "race to the bottom" dynamic is not without its own risks—particularly if the lender operates in a judicial foreclosure state where real estate liquidation can be very costly and time consuming.[209] Wise lenders will establish trip wires to help signal whether their lending standards are too low.

203. Ensuring the loan is recourse is critical at this phase because it impacts the incentives the borrower and its management will have as the loan deteriorates.

204. *See* Amy Fontinelle, *How the Debt Collection Agency Business Works,* INVESTOPEDIA (Feb. 17, 2021), https://www.investopedia.com/articles/personal-finance/121514/how-debt-collection-agency-business-works.asp [https://perma.cc/ZG5B-QHD8].

205. *See generally id.*

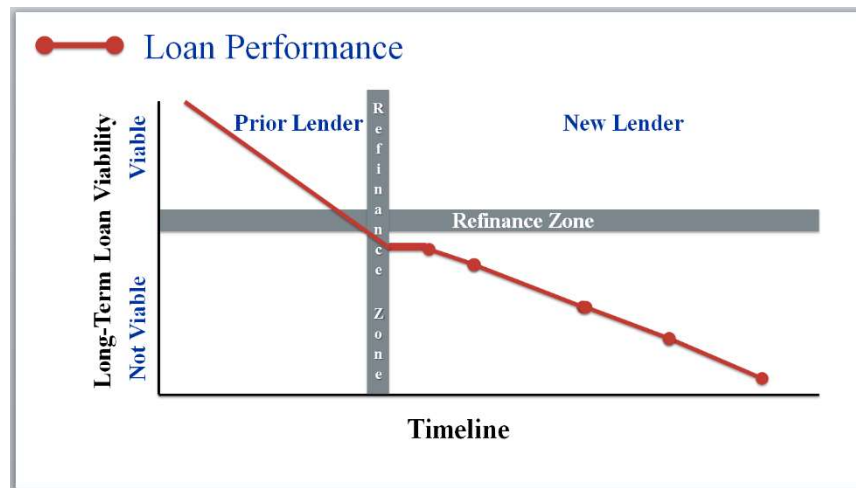
206. *See* Brian D. Feinstein, *Judging Judicial Foreclosure* 9-10 (Kreisman Working Paper Series in Hous. L. & Pol'y, Working Paper No. 43, 2017).

207. *See id.* at 1.

208. *See* JACK LIEBERSOHN, HOW DOES COMPETITION AFFECT BANK LENDING? QUASI-EXPERIMENTAL EVIDENCE FROM BANK MERGERS 12 (2017), http://web.mit.edu/liebers/www/liebersohn_jmp.pdf [https://perma.cc/5JU2-L4MF].

209. *See* Feinstein, *supra* note 206, at 9-10.

Finally, in handling the underwriting, it is essential for lenders to consider whether they are simply being asked to be the takeout lender for some other bank who has decided to take an early exit (hinge 3) from the borrower. The following graph illustrates this point:




Solid underwriting will not look solely at the immediate hard data regarding the loan but will also do a big picture analysis to see where the loan has been trending over the past few years. Putting in the extra effort at this early stage can have beneficial results, for it may help a lender spot red flags that other, less diligent lenders may fail to see. In short, hinge 1 (underwriting) is very critical. If the lender properly structures the loan, it will minimize the risk of future bankruptcy avoidance actions against it. However, if the lender does not fully think through the transaction, it can create a hidden pitfall for itself at the time of a bankruptcy filing.[210]

### *B. Hinge 2: Documenting the Loan*

Documenting the loan is the shortest and easiest hinge to understand. Once the lender has determined to proceed with the loan, it must then properly prepare the loan, have it appropriately executed, and record the necessary documents to ensure proper perfection in the collateral that has been pledged. Unlike the other

210. While it is beyond the scope of this Article, another key aspect of proper underwriting is ensuring the proposed loan is not subject to a bankruptcy avoidance action, such as a preferential transfer of a constructively fraudulent conveyance. *See* 11 U.S.C. §§ 547–548.

hinges where a right or wrong answer can be difficult to ascertain, answers to the second hinge are typically easy to verify under applicable law. The key is making sure the execution and recording of the loan documents also complies with applicable law.

Getting things done at hinge 2 is essential for future hinges, particularly hinges 4 through 7. If a lender fails to properly document a loan (i.e., missing a collateral description, failing to cross-reference related loan documents, or failing to properly perfect), the lender will—once the error is discovered—suddenly find itself playing defense and trying to cure the defect as indiscreetly as possible. This often requires the lender to either refinance the loan with new loan documents or get new loan amendments to cure the defect. However, both processes takes time, and that additional period may prove very costly if the overall loan continues its decline.

### *C. Hinge 3: The Early Exit*

The early exit is the most important hinge that a lender will face,[211] and refers to the lender's ability to discern that (a) the loan is in decline, (b) it will likely continue to decline, and (c) a viable lending market exists such that the borrower may refinance with someone else. An early exit means the lender signals to the borrower that the borrower needs to refinance the debt within some reasonable period with another lender. Lenders can send these signals by either indicating they will not renew an upcoming loan or by softly informing the borrower that, if present practices or conditions persist, a default will be triggered. And, under such circumstances, this default only be avoided through refinancing with someone else.

The occurrence of the hinge 3 depends on a myriad of factors, including: the type of collateral; the condition of the collateral; market conditions for the collateral; the borrower's business practices; the term of the loan; and status of loan payments. When a financial slide begins to occur with the loan, it can quickly turn into an avalanche. The key is to get off that slope before it becomes too late. In this regard, delay and procrastination can have huge costs for the lender.

Seasoned lenders know that both hard and soft data must be considered when making loan decisions.[212] Hard data refers to accurate financial reporting where

211. This hinge is typically encountered and addressed without the input of attorneys.

212. *See* V. McIntyre, *The Hard Facts on 'Soft Data': Determining risk for loan applicants without credit scores is more than a numbers game*, NEXT BILLION (Feb. 24, 2016),

key ratios and other common financial metrics are applied to evaluate loans. For hard data, key ratio and analytics include—but are not limited to—liquidity ratios (i.e., current ratio, debt service ratio, working capital ratio, and working capital to gross revenue ratio), efficiency ratios (i.e., interest expense, net income, operating expense), solvency ratios (i.e., debt-to-asset, equity-to-asset, debt-to-equity), and profitability (i.e., earnings before interest, taxes, depreciation, and amortization (EBITDA), net income, operating profit margin, rate of return on assets, rate of return on equity).[213] On the other hand, soft data refers to all other information learned about the borrower and its market, which in isolation may not be singularly worrisome, but when taken together reveal the true trajectory of the loan. Soft data includes information learned from on-site visits, deviations (good or bad) that the borrower is making when compared to other similar borrowers, and how other trade creditors deal with the borrower.[214] Over time the soft data indicating financial distress will be revealed in the hard data.

The problem with a hard data/soft data view is the tendency to limit the analysis based on the type of data classification, with some people giving more weight to the hard data while others give more weight to the soft data. Accordingly, the analysis of both hard and soft data is fertile ground for the representative and confirmation biases to flourish.[215] Seasoned lenders may develop heuristics where

https://nextbillion.net/the-hard-facts-on-soft-data-determining-risk-for-loan-applicants-without-credit-scores-is-more-than-a-numbers-game/ [https://perma.cc/MX6J-E5J3].

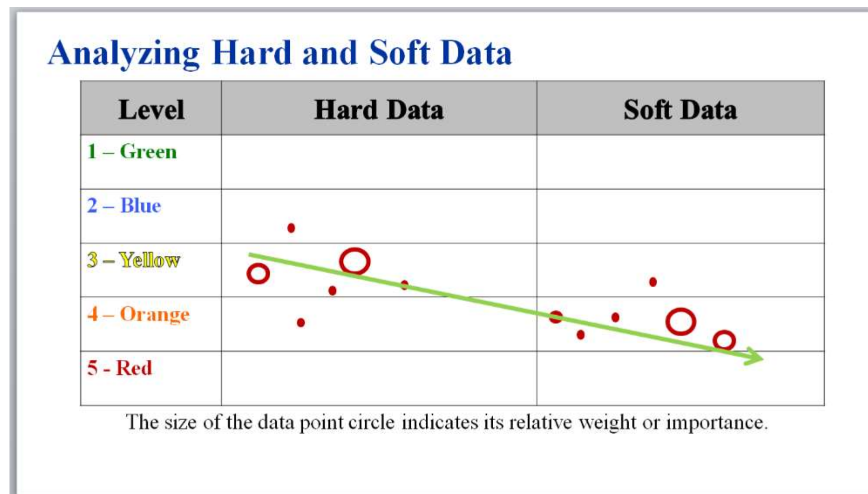
213. Key ratio and analytics include (but are not necessarily limited to) liquidity ratios (current ratio; debt service ratio; working capital ratio; and working capital to gross revenue ratio); efficiency ratios (Interest expense; net income; operating expense); solvency ratios (debt-to-asset; equity-to-asset; debt-to-equity); and profitability (EBITDA; net income; operating profit margin; rate of return on assets; rate of return on equity). *See What are Credit Analysis Ratios*, CORP. FIN. INST. (Feb. 2, 2021, 11:30 AM), https://corporatefinanceinstitute.com/resources/knowledge/finance/credit-analysis-ratios/ [https://perma.cc/Z3TE-G5FB]; *see also What are Efficiency Ratios*, CORP. FIN. INST. (Feb. 1, 2021, 11:04 AM), https://corporatefinanceinstitute.com/resources/knowledge/finance/efficiency-ratios/ [https://perma.cc/ZKW7-FDPX]; *Solvency Ratio*, INVESTOPEDIA, (November 9, 2020), https://www.investopedia.com/terms/s/solvencyratio.asp [https://perma.cc/C2SQ-KG48].

214. *See generally* McIntyre, *supra* note 212.

215. *See* Lovallo & Sibony, *supra* note 1, at 15-16 (noting that care must be taken to not let certain ratios lead to a false sense of security. For example, a cash-flow coverage ratio is important for determining a company's ability to service its debt, but EBITDA also has well-known shortcomings. While it is a proxy for cash flow, it must be realized that EBITDA is not cash flow, for it does not account for a company's capital expenditures or ability to manage its receivables and payables. EBITDA can be changed, for example, by altering a depreciation schedule, and it does not consider the underlying collateral, the structure of the loan, the borrower's market or other loan covenants).

they can see certain data points and immediately jump to conclusions regarding the borrower and its ability to rebound from a difficult situation.[216] The problem is that heuristics—or acting on gut hunches—sometimes prove to be inaccurate.[217] A heavy reliance on just hard or soft data is too binary in nature. Hard data points change over time, and soft data points are frequently leading indicators as to where the hard data points will be trending to in the future.[218] So how can the data be analyzed to yield better decisions?

Rather than limiting the analysis based on the type of data being gathered, a better approach is to consider the hard and soft data points, rank each particular data point according to its respective level of severity, and then compare the trend of the overall data points.[219] The following chart illustrates this point.




216. *See generally* James Chen, *Heuristics*, INVESTOPEDIA (Dec. 14, 2020), https://www.investopedia.com/terms/h/heuristics.asp [https://perma.cc/8QAN-K5T4].

217. *See id.*

218. *See What are Credit Analysis Ratios*, *supra* note 213.

219. *See* David M. Kohl, *Business and Financial IQ*, NW FARM CREDIT SERVS. (Oct. 1, 2018), https://www.northwestfcs.com/en/Resources/economic-updates/ag-economy-quarterly/business-and-financial-iq [https://perma.cc/76EP-FEYA] (noting Dr. David M. Kohl, Professor Emeritus at Virginia Tech Department of Agricultural and Applied Economics, has developed powerful insights for evaluating agricultural borrowers including the development of a list of Business IQ Management Factors and a Spectrum of Performance Possibilities.); *see generally* DAVID M. KOHL, SPECTRUM OF PERFORMANCE POSSIBILITIES (Feb. 21, 2020), https://www.farmermac.com/wp-content/uploads/Daves-GPS-Spectrum-of-Performance-Possibilities.pdf [https://perma.cc/R59E-J9MR].

The foregoing chart allows data points to be classified in five different areas, with level 1 being the best (a top performing loan) and level 5 being the worst (a loan with major problems). Additionally, some of the included metrics may be more critical than others. A very small circle represents a data metric that is not critical, while a larger circle represents one that is very important. An example of the latter is the working capital ratio, which reports how much cash is available to pay business obligations in the short term.[220] Virtually every borrower will have some financial ratios and benchmarks that may fall into differing levels. Because hard data is well understood in the lending community, each bank can institutionally establish criteria for ranking data on this five-tier scale. Soft data can also be classified on the five-tier scale with smaller circles representing less important points and larger circles representing more important points.[221] Once the data has been properly classified, a trend line can then be drawn to show the predicted loan trajectory if present conditions persist. Thus, in the example above, the downward trend line strongly indicates that pushing for an early exit is warranted.

Conversely—and as shown in the following chart—a borrower may go through a rough economic period (i.e., major weather-related damage to crops) that causes their overall financial metrics to be classified as a significant concern. At the same time, the soft data may suggest the borrower is doing a lot of things right,

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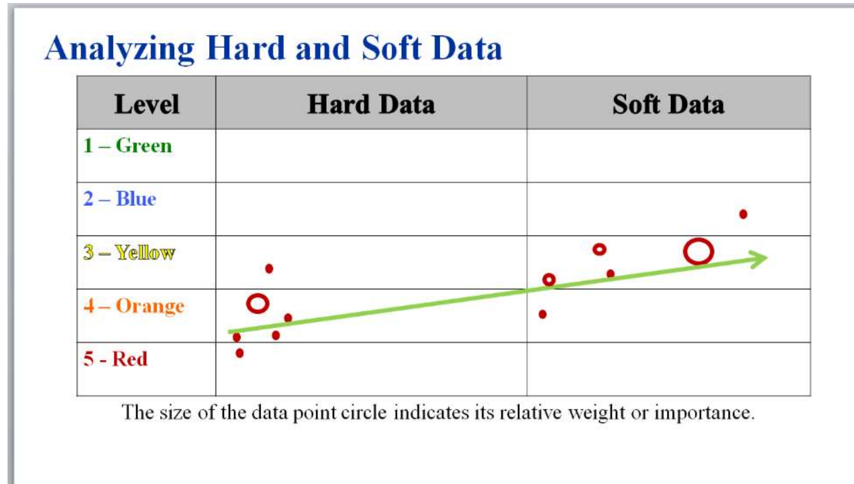
220. *See What is the Working Capital Formula?* CORP. FIN. INST. (Feb. 1, 2021, 12:24 PM), https://corporatefinanceinstitute.com/resources/knowledge/ modeling/working-capital-formula/ [https://perma.cc/HN88-XQQY].

221. Examples of concerning but low level soft data points may include: cutting corners to save money (i.e., skipping vaccines); poor record keeping (i.e., failing to track all income and expenses; poor farm management); poor cost control; focusing on size rather than profitability; having a high cost of living (i.e., having a nice house, nice vehicles, nice vacations, etc.); a borrower that appears oblivious to their deteriorating financial condition; personal denial of problems; failing to properly address a problem before it becomes a severe problem; comparatively poor production (i.e., below average county crop yields or above average livestock death rates); production costs which are comparatively excessive (i.e., a per bushel cost of $4.50 for bottom tier farms compared to a per bushel cost of $3.50 for top tier farms); domestic issues (i.e., divorce, substance abuse, anger issues); and increasing number of credit cards. More severe or Level 4 – Orange soft data points may include: failure to pay taxes (i.e., real estate, employee withholding, state or federal); aging payables; agricultural liens; possible refinancing with other lenders only available at higher rates; or declining loan-to-value ratios (i.e., growing farm debt or declining collateral values). Finally, Level 5 – Red soft data points may include: whether the borrower has been unable to refinance the debt with another lender; inability to repay working capital loans or repay term loan debt; on-site inspections reveal the headcount is less than reported or quality of crops is poor; out-of-trust sales are discovered by the lender; defaults on loans with other lenders; and lawsuits by suppliers.

such that, over time, loan conditions may improve. In this situation, the lender may be inclined to ride out the storm with the borrower and hope for sunnier days ahead.



The size of the data point circle indicates its relative weight or importance.

It is also important that hard and soft data points be measured over time. This is much easier to do with hard data, which can be readily classified and put into a spreadsheet in order to show trends. While not as easy to track over time, soft data should also be recorded, with newer soft data points being compared to prior ones. For example, if a lender has strongly emphasized the need for the borrower to improve its business practices, the lender would be wise to document what was happening at that time and then compare those same practices six months to a year later. Documenting those points—whether it be in a detailed memo or a ranking in a chart as detailed above—is critical to avoid hindsight bias when the borrower is reviewed again in the future.[222] In other words, memories are fuzzy and can be distorted by time. Having written documentation of how things were enables a more accurate comparison of present day soft data.

As noted above, a borrower's debt level, their available short term cash, and their ability to coordinate with various creditors impacts how they will choose to restructure their debts. Thus, focusing on metrics relating to these key points is critical for evaluating any distressed loan. The practical problem, however, is there are only good financial metrics for two of these three categories. More specifically, the debt-to-asset ratio, equity-to-asset ratio, and debt-to-equity ratio are all very

222. *See* Guthrie et al., *supra* note 120, at 799.

helpful in identifying total debt load.[223] Similarly, the working capital ratio, current ratio and working capital to gross revenue ratio are all helpful in identifying a borrower's liquidity.[224]

Unfortunately, there is not a good financial metric for measuring a borrower's ability to coordinate among its various creditors. Perhaps this is because such analytics tend to be more situationally dependent. The sheer number of creditors may not be a useful metric if the vast majority of them are small unsecured creditors, but a single, subordinate lienholder with large debt owed to it could prove to be very difficult for the creditor to work with in a distressed debt situation.

Given the lack of clear quantitative metrics in this regard, it is critical that lenders think about how the borrower's overall debt structure—both secured and unsecured—is evolving. That evolution changes the dynamics and incentives of the farmer. For example, subordinated secured debt, particularly on real estate, is indicative that the borrower cannot use cash flow from operations and must use existing real estate equity for liquidity. As debt with other creditors increases (particularly other secured creditors who may hold liens in the primary lender's collateral) there is a corresponding increased risk of litigation and associated costs.[225] Furthermore, this rising debt means the borrower has diminishing equity, which further increases the possibility of a default given that there is less to lose.

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223. *See generally* Ayotte & Morrison, *supra* note 46, at 514.

224. While not as critical on a day-to-day basis, net worth requirements, such as minimum net worth or debt-to-capital ratios, are important to a loan's recovery. The challenge with these covenants is they are frequently measured on generally accepted accounting principles (GAAP) rather than market values. Another drawback to these covenants is they do not account for the liquidity of the underlying assets (i.e., the nominal value of $1 million in market securities is worth less than a $1.2 million commercial property sitting in a small town whose major factory recently shut down).224.Rather than just applying a book value measurement, an alternative approach to simple net worth covenants would be to take the book value of assets and multiply them by a discount factor to account for the difficulty in liquidating the assets. For example, market securities would be their current trade value multiplied by .98 (the 2% discount reflects transaction costs and potential market fluctuations). In contrast, the commercial property alluded to above would be the property's value multiplied by .70 (reflecting the steep discount that likely would need to occur to sell it given its location and currently challenging economic environment). By taking a smarter, comprehensive approach to asset classes and asset locations, lenders can use analytics to develop better financial covenants and loan ratios that will ensure that more loans perform.

225. The incurrence of additional debt also reduces the lender's arsenal of workout options. For example, a second lien on real estate means the lender cannot do a deed in lieu of foreclosure but must proceed with foreclosure. This can prove to be very costly if the lender operates in a judicial foreclosure state.

One possible way for a senior secured lender to mitigate difficulty associated with subordinated debt is with a clear inter-creditor agreement that delineates what happens in the event the borrower becomes financially troubled.[226]

In sum, the early exit is the most important hinge for a lender in a distressed loan because it is the key opportunity to avoid a mountain of headaches resulting from a distressed loan.[227] Given the critical nature of this hinge, lenders would be wise to develop solid methodologies for evaluating both hard and soft data to best identify when an early exit is warranted. Lenders also need to learn how to have tough discussions with borrowers about their financial welfare (i.e., being able to say, "you are inefficient and need to exit."). As a lender improves their ability to act at this hinge point, they will minimize the number of loans that ultimately fall into true financial distress.

### *D. Hinge 4: Forbearance*

When lenders miss their early exit opportunity, hinge 4 is the opportunity to do a forbearance agreement wherein the trajectory of the loan will hopefully change from downward to upward. Stated differently, the forbearance agreement attempts to get out of or minimize the challenging situation the lender now finds itself.[228] The timing of when a forbearance agreement is done can make a big difference. If loan deterioration signs are spotted early—and the issue of averting a major loan default is also promptly raised—then there is more time to work with the situation.[229] If the lender waits until a point where the borrower is really hurting financially, then the forbearance agreement may actually be counter-productive to the lender due to the demands the borrower will be facing from other creditors.[230] Hence, a key aspect of this fourth hinge is staying ahead of other creditors to put the lender in a better position vis-à-vis other creditors.

226. *See* Cunningham & Galil, *supra* note 109, at 54.

227. *See* Chatterjee et al., *supra* note 79, at 359.

228. *See What is mortgage forbearance?*, CONSUMER FIN. PROT. BUREAU (Aug. 29, 2019), https://www.consumerfinance.gov/ask-cfpb/what-is-forbearance-en-289/ [https://perma.cc/G36L-YVFJ].

229. *See generally id.*

230. Furthermore, if the lender erred at either the first or second hinge, then it will likely be forced at the fourth hinge to take time and attempt to fix the problems. But, if the lender is taking its time to fix problems, the loan situation may be continuing to deteriorate.

*1. Likelihood of Workout Success*

Before incurring the time and expense of attempting to do a loan workout, a wise lender will consider whether a workout attempt will be successful, or if it is just a means of delaying an inevitable insolvency proceeding.[231] Fortunately, there is some academic research helping guide this key decision. A borrower's debt level, their available short-term cash, and their ability to coordinate with various creditors impacts how they will choose to restructure their debts.[232] A loan workout is significantly influenced by both the recourse nature of the loan and the ability to do a loan restructuring.[233] The existence of recourse deters strategic defaults and increases the likelihood of a loan workout.[234] However, if a lender converts a recourse loan into a non-recourse loan through part of a forbearance proceeding, it increases the likelihood of a default.[235]

Another key concern in addressing a loan workout is the amount of information the relevant parties have. One researcher has noted

> [i]mpediments to reaching a settlement in a private restructuring include information asymmetries that arise between poorly informed outside creditors and better informed managers or insiders of the firm; holdout problems when the firm's debt is held by a large number of diffuse creditors; and various conflicts of interest exacerbated when a firm has multiple layers of creditors.[236]

Cash flow is a critical consideration in determining whether the loan workout will be successful, for companies that restructure outside of bankruptcy have strong operating liquidity.[237] One study considered workout strategy for commercial mortgages and the probability of conditional default. It found the most significant factor in a loan servicer's decision-making is cash flow.[238] The study also found that borrowers' default decisions are determined by both the amount of

231. *See* Chatterjee et al., *supra* note 79, at 335.

232. *See generally id.*

233. *See* DANIEL LEBRET & DANIEL C. QUAN, FROM DELINQUENCY TO FORECLOSURE: A MODEL OF LOAN WORKOUTS 18 (SSRN ed., May 31, 2017), file:///C:/Users/ag%20law%20journal/Downloads/SSRN-id2978154.pdf [https://perma.cc/WBU5-726N].

234. *See id.*

235. *See id.*

236. *Bankruptcy and the Resolution of Financial Distress*, *supra* note 49, at 243.

237. *See generally* Chatterjee et al., *supra* note 79, at 341.

238. Chen & Deng, *supra* note 74, at 609.

equity in their mortgage as well as the cash flow condition of the market.[239] Given this, it makes sense companies that tend to do pre-packaged bankruptcies have strong operating performance but also have an immediate liquidity challenge.[240]

Therefore, in considering a loan workout or forbearance agreement, it is critical to recognize the borrower's existing debt structure will impact what sort of debt restructuring is likely to be successful. A lender considering a workout scenario should not only consider cash flow but should also strongly consider the borrower's present and anticipated future debt structure.[241] Stated differently, identifying different debt structures will materially guide a lender on the best course to take.

Research reveals a company's debt structure impacts how it reorganizes when it becomes financially distressed.[242] The probability of a private workout is increased if the company has fewer distinct debt classes and a larger percentage of the company's debt is long term bank debt.[243] But, the more diffused the borrower's debt is among different creditors, the more severe the problem of a holdout creditor becomes.[244] Furthermore, a distressed company will be less likely to liquidate its assets if the industry in which it operates is also generally distressed and highly leveraged.[245]

Borrower equity is an important consideration within the workout process. One study found real estate properties that were both highly leveraged and owner-managed were more likely to foreclose.[246] Speed also matters in workouts.[247] For example, one study found if the distressed loan resolution was quick, then there was higher capital recovery rates for portfolio loans.[248] Additionally, market conditions should always be considered.[249] One study that looked at distressed

239. *Id.*

240. *See generally id.*

241. *See generally* Robert Gertner & David Scharfstein, *A Theory of Workouts and the Effects of Reorganization Law*, 4 J. FIN. 1189, 1216 (1991).

242. *See* Asquith et al., *supra* note 34, at 7.

243. Gilson et al., *supra* note 107, at 316.

244. *Id.* at 321.

245. Asquith et al., *supra* note 34, at 1.

246. Brown, *supra* note 88, at 470.

247. *See* David H. Downs & Pisun (Tracy) Xu, *Commercial Real Estate, Distress and Financial Resolution: Portfolio Lending Versus Securitization*, 51 J. REAL EST. FIN. & ECON. 254, 255 (2014).

248. *Id.*

249. *See* Brown et al., *supra* note 68, at 1358.

commercial real estate loans found, when the market was in a downturn, foreclosure occurred more frequently. But, when the market improved and there was also a readily available market for foreclosed properties, restructuring was more common.[250]

What factors determine whether a company is more likely to restructure their debts outside of bankruptcy versus inside of bankruptcy? One study looked at publicly traded companies and found about half of distressed companies restructured their debt without filing for bankruptcy protection.[251] If a company had more intangible assets, had relatively fewer lenders, and had its debt held predominantly by banks, then it was more likely to do a private restructuring.[252] The study also suggests equity holders fared better when debt was restructured privately as opposed to going through bankruptcy.[253]

*2. Elements to Successful Workouts*

If the lender determines a forbearance agreement should be pursued then there are several important items the lender should consider incorporating it into the workout agreement. To begin, a lender would be wise to obtain better control over the situation by establishing key milestones the borrower has to meet. If those milestones are not accomplished or properly excused, then the forbearance agreement should have clear and unambiguous provisions about the lender's default remedies. Ideally, those default remedies should not be conditioned upon notice or time requirements but should allow the lender to immediately act to enforce them.

The relative amount of bargaining power by each side is also important during the workout process. Lenders can limit their borrowers' bargaining power by creating high distress costs and decreasing the time period allowed for a workout.[254] High distress costs can be created by requiring the pledge of new collateral, new guaranties, or the imposition of springing guaranties for related third parties who may have the ability to influence the borrower.

250. *Id.*
251. Gilson et al., *supra* note 107, at 315.
252. *Id.*
253. *Id.*
254. LEBRET & QUAN, *supra* note 233, at 2.

One item frequently overlooked in forbearance agreements are requirements for maintaining key ratios.[255] Lenders would be wise to require the borrower to maintain certain key ratios as that will help foster a viable workout.[256] The problem, of course, is the lender is dependent on the borrower for the information and the key ratio requirement creates an incentive for the borrower either not to share the data or to fudge the data if it is not as good as hoped. Lenders can overcome these barriers by requiring detailed and timely reporting of key data metrics to them and by increasing the level of borrower monitoring.

Given that prior management put the borrower into their current financial distress, it is somewhat common for lenders to require the borrower to hire a chief restructuring officer in forbearance agreements, whose role will be to complete an orderly liquidation of the company or attempt to meaningfully turn it around. Forbearance agreements can also require borrowers to hire key professionals, such as accountants or tax advisors, to obtain proper advice to address challenging issues.

Finally, when entering into a forbearance agreement, a lender should also clearly identify for itself the point at which it will stop forbearing. In reality, not all forbearance agreements result in a positive workout. Sometimes this is a result of market conditions. But other times it is simply a result of existing management continuing their poor business practices without making any meaningful progress. At some point, collection remedies and litigation become inevitable. By identifying those trip wires, the lender can be better prepared to address the fifth hinge—default remedies.

### *E. Hinge 5: Pursuing Default Remedies*

The fifth hinge focuses on the manner and method by which the lender will pursue its default remedies given the deteriorating loan situation. In this regard, timing is critical to maximizing loan value. Before immediately rushing to liquidate, a lender would be wise to think through the different liquidation scenarios and try to anticipate how the borrower will react.[257] What are the

255. *Top 10 Things a Lender's SBA Credit Analysis Must Address*, SBACOMPLETE (March 7, 2021, 10:23 AM), https://sbacomplete.com/knowledge-center/resource/top-10-things-a-lenders-sba-credit-analysis-must-address/ [https://perma.cc/76NY-RMJY].

256. *See id.*

257. *Strategic Orderly Liquidations*, GORDON BROTHERS (Oct. 2013), https://www.gordonbrothers.com/insights/article/orderly-liquidations [https://perma.cc/GH8E-JR5D].

borrower's key incentives?[258] How will they decide to react once collection remedies start?[259] This may necessitate developing not only a Plan A, but also a Plan B and possibly a Plan C. Ultimately, it may be that there is not an optimal plan but rather three or four different options (with their own varying degrees of time, cost, and uncertainty) that may reach the same result.

Timing is critical in determining when to liquidate. For example, selling livestock prematurely before they are ready for market will likely result in a significantly lower distribution.[260] Likewise, if the loan collateral is crops, one needs to determine whether additional inputs are needed to maximize the harvest yield. If the collateral is real estate, is it being actively cared for or is it (or will it be) neglected with weeds growing on it to negatively impact its value? For agricultural loans it is critical to consider enforcement in the context of the growth stage of the collateral.[261] If the collateral is crops, at what stage of the growing season are you in? Are any additional inputs needed to bring the crop to maturity for harvesting?

Market conditions are also important to consider, given the seasonality of agricultural loans and the global competitiveness of agriculture generally.[262] Markets for agriculture-related items (including crops, livestock, equipment, and real estate) wax and wane. Swings in crop and livestock prices occur more frequently, while equipment and real estate prices fluctuate more slowly with time.[263]

When considering default options, a lender should also consider estimated collateral value and the cost of liquidating the collateral. Given the prevalence of online auctions and market reports, there tends to be reasonably decent barometers

258. *See id.*

259. *See id.*

260. Victoria G. Myers, *Price Boosters*, PROGRESSIVE FARMER (Aug. 5, 2019, 9:14 AM), https://www.dtnpf.com/agriculture/web/ag/livestock/article/2019/08/05/sale-barn-veterans-secrets-hitting [https://perma.cc/M7AA-TD5B].

261. *See* N.N. Vnukova, *Cost Estimation of the Future Harvest as Agricultural Loan Collateral*, 2 J. GOVERNANCE & REG. 25, 26 (2013).

262. Mark Welch et al., *Seasonality and Its Effects on Crop Markets (Risk Management Series)*, TEX. A&M AGRILIFE EXTENSION (March 7, 2021, 11:14 AM), https://agrilifeextension.tamu.edu/library/marketing-risk-management/seasonality-and-its-effects-on-crop-markets-risk-management-series [https://perma.cc/Y783-LC3D].

263. *Id.*

for estimating the value of equipment, livestock, and grain.[264] Additionally, a lender is generally aware of the overall farming economy and can generally see—at least in the short term—where the market for a particular collateral item is headed. In short, in analyzing default remedies, the lender should seriously ask itself the following three questions: (1) what percent of the collateral does it estimate it will recover after factoring in non-attorney fee liquidation costs; (2) how long will it take to liquidate the collateral; and (3) what are the estimated attorney's fees for liquidating the collateral?

The determination of when to enforce default remedies impacts the borrower's leverage in bankruptcy. Does the lender want to aggressively take pre-bankruptcy actions to recover cash collateral so as to starve the borrower of liquidity, thereby putting it into a financial death spiral? Or does the lender continue to work with the borrower? As a practical matter, if the borrower moves its bank accounts, then it is probably time for an aggressive strategy—move fast, move quick, take the losses and move on. As one loan officer once noted, "Your first loss is your best loss."[265]

As an alternative to litigation a lender may want to consider pre-lawsuit mediation as an alternative. Iowa takes an interesting approach to the resolution of distressed agricultural loans by requiring the parties mediate before the lender can file a lawsuit.[266] There are certainly benefits to a mediator bringing parties together. But a key problem with mediation—particularly in a multi-creditor farming operation—is not all the relevant parties may be at the table and a true comprehensive deal cannot be reached. Even if they are at the table, other creditors may pursue strategies to obstruct the senior secured lender as a means of extracting concessions for themselves.

264. Adam Arsenault et al., *Outstanding in the Field: Evaluating Auction Markets for Farmland Using Multi-Agent Simulation*, JASSS (Jan. 12, 2012), http://jasss.soc.surrey.ac.uk/15/1/11.html [https://perma.cc/92G6-LB74].

265. Jim Cramer, *Ten Commandments of Trading: Commandment 2*, THESTREET (March 23, 2021, 4:20 PM), https://www.thestreet.com/static/command2.html#:~:text=You%20have%20to%20be%20willing,loss%20is%20your%20best%20loss [https://perma.cc/72UX-UEEK].

266. IOWA CODE § 654A.4 (2021).

### *F. Hinge 6: Bankruptcy Financing*

#### *1. Should DIP Financing be Provided?*

As the borrower continues its downward financial slide and bankruptcy becomes highly likely, the lender is presented with the sixth hinge—debtor-in-possession (DIP) financing. As the lender reaches this hinge, the two fundamental questions are: (1) should DIP financing be provided and, if so, then (2) under what terms should it be given? The importance of this sixth hinge really depends on whether or not the debtor can cash flow from existing operations. If the debtor can cash flow in bankruptcy (i.e., make payment of post-petition obligations and operating expenses as they come due based on on-going operations), then the debtor should be considered for DIP financing. In doing that analysis, if the borrower/debtor needs the lender to provide financing then the lender has more leverage over the debt resolution. But if the borrower/debtor can acquire cash flow without the benefit of the lender, either through the existing cash they have on hand or with the help of an alternative DIP lender, the pre-petition lender will have less leverage over the bankruptcy proceeding, which, in turn, may adversely impact its ability to recover on the loan.[267]

There are two key bankruptcy related benefits a company has if it acquires DIP financing. First, whether a borrower has access to DIP financing is an important indicator as to whether a company will be able to successfully reorganize.[268] Stated differently, companies that obtain DIP financing are more likely to emerge from Chapter 11 than companies that do not.[269] In fact, the duration of bankruptcy proceedings is even shorter when the bankruptcy DIP lender is the same lender that provided the pre-petition lending.[270] Furthermore, smaller debtors are more likely to obtain DIP financing from their pre-petition lenders.[271] Intuitively, this makes sense. Third-party lenders are more likely to view the troubled company as a financial risk and thus, are less likely to make the loan. In contrast, an existing lender has better information and a greater likelihood

267. Sandeep Dahiya et al., *Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence*, 69 J. FIN. ECON. 259, 266 (2003).

268. *Id.* at 262-63; *see* Maria Carapeto, *Does Debtor-in-Possession Financing Add Value?*, CASS BUS. SCH. (Oct. 6, 2003), http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.197.6324&rep=rep1&type=pdf [https://perma.cc/AG49-73CD].

269. Dahiya et al., *supra* note 267, at 271.

270. *Id.* at 268.

271. *Id.* at 270.

of loss if the debtor liquidates. Hence, it has an incentive to do DIP financing to minimize the likelihood of liquidation.[272]

Second, bankruptcy proceedings tend to be shorter for a company that obtained DIP financing.[273] This is true for both reorganizations and liquidations.[274] Given the potentially high costs of a bankruptcy proceeding, there is a strong incentive for both the primary lender and the borrower to minimize the duration of the bankruptcy case to reduce the administrative fees and expenses that must be paid to professionals working on the matter. Hence, DIP financing provides an effective means for putting the borrower on much better financial footing for a prompt turnaround.[275]

*2. Successful DIP Financing*

Given a borrower's ability to obtain DIP financing correlates to a higher possibility of emerging as a reorganized entity,[276] there is an incentive for lenders to seriously consider providing DIP financing.[277] While the best practices for DIP financing in its entirety are beyond the scope of this Article, there are some key points lenders should keep in mind as they contemplate whether to provide DIP financing.

Ideally, it is best that DIP financing discussions occur before bankruptcy is filed. Pre-bankruptcy negotiations can be quicker, to the point, with fewer distractions, and without the rush of bankruptcy-related issues that occur once a case is filed. Taking time before bankruptcy to properly construct DIP financing loan documents can save both the lender and borrower significant time, fees, and headaches if an agreement can be reached before the filing.

It is critical that the DIP financing be drafted so: (a) critical milestones are unambiguous such that everyone unquestionably knows whether they have been reached and, (b) if they are not reached, the remedies should be automatic so no further judicial intervention is required to impose the remedy. These remedies, of course, can range from mild to severe repercussions. In large bankruptcy cases,

272. *Id.* at 262.
273. *Id.* at 261
274. *Id.*
275. *Id.* (noting that it is not a surprise larger companies are more prone to obtaining DIP financing).
276. *Id.* at 271.
277. *Id.* at 262.

secured lender control is significant through tight covenants in DIP loans, including items like line-item budgets.[278] Secured lender control through DIP financing may also extend to revenue, production metrics, and key deadlines for certain events to occur in the bankruptcy proceeding. This control may yield short term benefits for the lender. Academic research has shown, if the senior secured lender is over-secured, there is a much higher probability there will be a sale of the firm's assets.[279]

### *G. Hinge 7: Plan Confirmation*

The seventh major hinge encountered by lenders is the borrower/debtor's proposed plan of reorganization. The proposed plan is tremendously important to the lender because it will govern the parties' contractual relationship for years to come. Plan confirmation remedies may include loan cramdown, bifurcation of the loan into secured and unsecured portions, replacement of underlying collateral, imposition of a new interest rate, changing of loan covenants, and modification of default remedies. In short, the plan can have a major impact on the lender.

In the context of bankruptcy, banks prefer liquidation and do not favor reorganization.[280] Aside from the strong incentive banks have to minimize their losses through the immediate recovery of a liquidation,[281] there is also a practical realization that bankruptcy frequently enables inefficient borrowers to reorganize. Stated differently, a practical problem is the pro-debtor structural bias of the Bankruptcy Code (and, frankly, judges to some extent) allows confirmation when debts have not been properly dealt with (e.g., the debtor still has too much debt). This issue is very problematic because it sets things up for more failure down the road. Lenders need to be able to identify this. For example, one study found plants retained by reorganized debtors had lower productivity than their assets that were sold—an indication the better performing assets were liquidated while the underperforming assets were retained.[282]

The bankruptcy process itself can be good for borrowers. A large study of cases from the 1990s found companies that filed for Chapter 11 had significant

278. Ayotte & Morrison, *supra* note 46, at 514.
279. *Id.* at 511.
280. Bris et al., *supra* note 83, at 1262.
281. *Id.*
282. Vojislav Maksimovic & Gordon Phillips, *Asset Efficiency and Reallocation Decisions of Bankrupt Firms*, 53 J. FIN. 1495, 1496 (1998).

improvement of operating performance while in bankruptcy.[283] Companies that had higher debt ratios had better operating performance improvements.[284] But, that operating improvement was not as good if there were complex debt renegotiations.[285]

What increases the likelihood of bankruptcy confirmation success? One paper that considered successful individual Chapter 11 cases noted three key factors: (1) jointly filed cases, (2) handled by an experienced attorney, and (3) substantial real estate.[286] Another study noted if a company significantly reduces both assets and liabilities through its Chapter 11 bankruptcy then it is more likely to emerge as a growing concern.[287]

A successful plan confirmation does not necessarily mean the borrower has successfully reorganized. One study found if the borrower's pre-petition management continued as part of the restructuring process there was an increased probability of failure following bankruptcy.[288] Another study found more than two out of three of companies that emerged from bankruptcy performed worse than their peers in the five-year period following emergence and more than 18% had negative income in the first year following bankruptcy.[289] Researchers reviewed numerous studies that looked at post-confirmation success of Chapter 11 debtors and noted, generally speaking, the reorganized debtors continue to perform poorly.[290] But if a so-called "vulture investor" remains actively involved with the borrower following bankruptcy, the likelihood of the lender experiencing operating losses has been shown to be very low.[291]

## V. GETTING BETTER RESULTS AT EACH HINGE

Resolving distressed debt is difficult given the differing incentives of the parties, the legal rights and remedies, the uncertainty of the situation and the raw

283. Avner Kalay et al., *Is Chapter 11 Costly?*, 84 J. FIN. ECON. 772, 794 (2007).

*284. Id.*

285. *Id.* at 794.

286. Richard M. Hynes et al., *National Study of Individual Chapter 11 Bankruptcies*, 25 AM. BANKR. INST. L. REV. 61, 61 (2017).

287. Denis & Rodgers, *supra* note 84, at 101.

288. *Postbankruptcy Performance and Management Turnover*, *supra* note 48, at 4.

289. Edith S. Hotchkiss & Robert M. Mooradian, *Postbankruptcy Performance of Public Companies* (B.C. & Ne Univ., Working Paper, 2004) (on file with author).

290. *Bankruptcy and the Resolution of Financial Distress*, *supra* note 49, at 14.

291. Edith S. Hotchkiss & Robert M. Mooradian, *Vulture Investors and The Market for Control of Distressed Firms*, 43 J. FIN. ECON. 401, 403 (1997).

emotion that is exhibited in the face of hard challenges. The sheer complexity of distressed debt resolution means there is no easy five-step formula to magically fix the situation. The reality of the matter is sometimes there are simply very hard situations with no easy fix. The goal is for the lender to be positioned as well as possible for dealing with those challenging dilemmas. To do this, there are key practices, when consistently employed at each of the different hinges, help in the overall outcome. To use a bit of an extreme but illustrative analogy, it's not about doing one big thing right, but rather it is a matter of doing 1,000 small things really, really well.

### *A. Build and Maintain Trust*

The first thing lenders should do is constantly seek to build and maintain trust.[292] Lenders should also strongly emphasize the borrower's honesty, good faith, and integrity, which is critically important to resolving challenging issues. Trust is essential to getting deals done. High trust means there is less friction and more conciliation; indicating deals can be reached sooner and less expensively. Conversely, low trust engenders mistrust, unnecessarily prolonged bickering, and overall higher costs.

Trust does not mean one party capitulates to the demands of the other party. Rather, trust is more about knowing a lender will do what he or she says they are going to do. Trust is also about giving a borrower an opportunity to perform their own obligations. Wise lenders will signal to their borrowers that it will be much easier to work with the bank when trust is high, but if the borrower begins to breach that trust then the bank may be more difficult to work with.[293]

Trust alone is not enough to resolve a distressed loan. For example, even if trust is high but the ability to generate income is insufficient, there needs to be an exit path. However, trust facilitates that exit effort because the lender can clearly communicate to the borrower the relationship is over and the borrower needs to move on. While this may be difficult for the borrower, trust enables a dignified split between both parties.

292. For an in-depth expansion on the power of trust, see STEPHEN M.R. COVEY, THE SPEED OF TRUST: THE ONE THING THAT CHANGES EVERYTHING (2006).

293. The loan officer should have a strong relationship of trust with the borrower when information is provided. However, key decision-making authority should be out of the loan officer's hands. That way he or she can "blame the system" while still maintaining trust and continuing to get information that will be essential for the lender to make an informed decision.

Sometimes there is a temptation to provide misleading information as a means to obtaining some tactical advantage. Resist the temptation! Once a counterparty compromises its integrity, it will be more likely to be compromised again in the future. Rather, a lender will avoid a lot of unnecessary problems if it constantly employs ethical standards that foster trust.

### *B. Constantly Get Information*

The number one rule of negotiation is to constantly get more information.[294] As detailed in Part IV (Hinge 3), both hard and soft data are needed. In the agricultural world it is imperative that lenders make regular on-site visits—boots on the ground—to really get a feel for what is happening with the operation. Information gathering is not just limited to the borrower and the loan performance. Rather, wise lenders will also know about their borrower's operations so they can spot potential third-party liability risks. This is essential so the lender can better determine what third-party creditor risks may exist and how it may impact both future loan performance and the borrower's incentives. For example, if the borrower has a concentrated animal feeding operation (CAFO), then there is a risk of nuisance lawsuits or environmental law related challenges, ranging from permitting issues to water quality and animal care issues.[295] If the borrower is leasing the property to a producer, the borrower may still be subject to legal challenge by virtue of the property ownership. Given their preexisting relationship with the borrower, informational asymmetries tend to happen less with banks as opposed to other types of creditors.[296] A theoretical model developed by researchers revealed a negative correlation between restructuring rates and the degree of informational asymmetries.[297] In other words, better information makes it more likely a successful loan workout can occur.

### *C. Constantly Evaluate Biases and Incentives*

As new information is constantly gathered, wise lenders should consider how decision biases of the lenders, the borrowers, and third-party creditors may be

294. *See generally* MARTIN E. LATZ, GAIN THE EDGE! NEGOTIATING TO GET WHAT YOU WANT (Griffin Pub., 2005).

295. Even if the borrower has a feeding arrangement with a third-party who has custody of the cattle, the borrower may still be liable for a nuisance claim given that it owns the cattle.

296. Gilson et al., *supra* note 107, at 324.

297. Manuel Adelino et al., *Identifying the Effect of Securitization on Foreclosure and Modification Rates Using Early-Payment Defaults*, 49 J. REAL EST. FIN. & ECON. 352, 369 (2013).

impacting the situation.[298] In doing this evaluation, one key question is whether the biases of other parties can be leveraged to help achieve the lender's desired outcome. Another important inquiry is whether additional information can be "injected" to influence biases, such as providing an appraisal to help dispel the anchoring bias. While not all biases can be eliminated or used for the lender's benefit, recognizing the opportunity to do so will open creative new ways for lenders to try and solve perplexing loans.

In addition to evaluating biases, lenders should also constantly evaluate incentives—particularly those of their borrowers. This is critical to better predict how the borrower is likely to react as the loan deteriorates. In this regard, key areas of inquiry include the amount of equity the borrower has on the collateral, whether there is emotional equity tied to the property (e.g., 5th generation family farm), what the borrower's long term strategy is, and what creditors the borrower needs to appease to make their long term strategy viable. By seriously considering these issues, lenders can develop a more realistic plan for the loan situation.

### *D. Align Incentives*

At each of the seven hinges lenders should strive to align the borrower's incentives with the lender's interests. At hinges 1 and 2, this is done by obtaining the traditional loan remedies of security in collateral, key covenants and ratios that must be maintained, a personal guaranty, etc. But, as the loan begins to deteriorate and negotiations ensue between the parties, the lender would be wise to consider additional steps to insure incentive alignment. For example, at hinge 4 (forbearance), the lender may require additional covenants, ratios, or other key milestones be met. The lender may also demand additional collateral be pledged. Or the lender may agree to only waive claims if the borrower does certain things. By creating high distress costs for a borrower, the lender will better align the borrower's incentives to match the lender's interests.

### *E. Establish Control*

A lender should take steps and put requirements in place that result in more lender control and greater predictability of results when key events occur. Put differently, the judicial process is slow, can be unnecessarily prolonged, and judicial decisions are never 100% certain—so why place the outcome of a distressed loan in that situation? There is a trend for large creditors of corporate

298. *See supra* Part III for a more thorough analysis of these biases.

debtors to exert greater influence on their borrowers.[299] This control is derived through their pre-bankruptcy contracts containing restrictive covenants and key veto rights that enable the lender to assert control over certain corporate actions.[300] If creditors hold more power in a bankruptcy workout, then that increases the likelihood the company will perform better following bankruptcy.[301] This result should not be surprising. As Chang and Schoar have found, "[o]n average creditors rather than debtors seem to be pushing for restructuring solutions in Chapter 11 that allow for more successful continuation of the firm."[302]

Lenders should strive for appropriate control at each hinge point. Control at hinges 1 and 2 is created by the specific loan terms, loan covenants, and key ratios that must be met. Control at hinge 3 (early exit) is exerted through the lender's refusal to renew the loan and to push the borrower to refinance somewhere else. Control at hinges 4, 6, and 7 (forbearance, DIP financing, and plan confirmation, respectively) is exhibited through key requirements in a forbearance agreement, DIP financing agreement, and the proposed plan. Control at hinge 5 (default remedies) is exhibited by how aggressively and in what manner the lender pursues remedies given the defaulted loan. By constantly seeking to increase its control at each hinge, the lender better positions itself to direct the outcome of the situation.

### *F. Avoid the "Empty Core"*

One challenging issue with distressed loans is the "empty core."

> An "empty core" exists when three or more parties cannot reach a stable agreement with each other because some other agreement always exists that at least one party prefers. In other words, at least one person will always defect from any tentative agreement that might be made and, hence, none ever is reached.[303]

The empty core is particularly prone to occur if transaction costs are low, which creates a situation where agreements are difficult to stick.[304]

299. Michelle M. Harner & Jamie Marincic, *Behind Closed Doors: The Influence of Creditors in Business Reorganizations*, 34 SEATTLE UNIV. L. REV. 1155, 1155 (2011).

300. *Id.*

301. Chang & Schoar, *supra* note 129, at 3.

302. *Id.* at 3-4.

303. Baird & Rasmussen, *supra* note 29, at 690 n.190.

304. *Id.*

The empty core is often manifested in bankruptcy proceedings when three or more parties (the debtor and two or more key creditors) have strong and differing economic incentives.[305] There is a real "danger that the bankruptcy process degenerates into repeated and costly attempts at coalition building."[306] Sometimes it is necessary to take strong steps to either "create focal points or otherwise ensure that the core is not empty."[307] Stated differently, the empty core problem can be overcome by creating a focal point by which other parties can begin to coalesce to resolve the overall empty core problem. Sometimes this can be done by creating binding side agreements with key parties.[308] At other times a judicial ruling on a key point is necessary to create a new focal point that becomes the pathway for a global resolution.

### *G. Identify and Eliminate Settlement Barriers*

There is a trade-off with settlement. A compromise increases the speed of resolution and can decrease litigation time. But a frequent problem is neither party may want to meaningfully compromise. When these situations occur (and they frequently manifest early in the dispute resolution process), it is critical to ascertain why the parties are unwilling to compromise. In other words, what barriers to settlement exist and how can they be eliminated? Identifying these barriers requires some thought and analysis.[309] While not all settlement barriers can be eliminated, there are others that can be. Thus, instead of trying to strike a deal, a more effective short term strategy may be taking steps to eliminate a key barrier that impedes the borrower from reaching a compromise. This may be done in a myriad of different ways depending on the situation. For example, it may necessitate striking a side deal with a key subordinate lienholder. It could require injecting key new information into the situation. It could also require a lender to do a harder internal analysis about the true costs of its desired result to come to the realization the expected costs actually outweigh the potential risky benefit. Key deadlines may be needed to bring finality to the situation.

305. *Id.* at 691.

306. *Id.*

307. *Id.* at 696.

308. *See id.* at 673.

309. Key questions to help in this regarding include the following: What are the lender's internal and external limitations on compromise? What are the borrower's internal and external limitations on compromise? How much of the barrier to compromise is driven by emotion and anger? How much of the barrier to compromise is driven by lack of information? Has the lender properly calculated the cost of not compromising?

### *H. Employ a Decision-Making Methodology*

As noted above, a study of major corporate decisions revealed that "process mattered more than analysis—by a factor of six."[310] Consequently, business decisions should not be limited to just analytics and consultation with competent legal counsel. Rather, smart decision-making for a distressed loan should also employ a sound decision-making process. Brothers Chip and Dan Heath have developed an insightful and easy to remember methodology for an effective decision-making process known as the WRAP method.[311] Specifically one should: (W) widen options, (R) reality-test assumptions, (A) attain distance before deciding and (P) prepare to be wrong.[312] When confronted with a decision at any of the hinge points, a lender would be wise to remember this simple mnemonic and think through each of those four points. Specifically, are there more options available? Are there small and different ways the proposed approach can be tested to see if it will work? Is it possible to allow a small period of time, such as waiting over the weekend to let the ideas percolate in one's mind, to see if better insights can be attained? How can the lender best readjust if its initial decision proves to be wrong?

### *I. Be Prepared for Legal Proceedings*

Unfortunately, not all distressed loans are consensually resolved. Sometimes legal intervention is necessary. So how can a lender best prepare itself for this? The lender should properly and thoroughly document all loan defaults and noncompliance. Litigation is a matter of persuading the judge to accept the litigant's position; a hunch or suspicion is not enough. The evidence needs to be both admissible and tangible. Successful persuasion will be more likely to occur if there are well-documented and vivid examples of the breach that has occurred.

## VI. CONCLUSION: FUTURE AREAS OF RESEARCH

There is little academic research regarding distressed agricultural loans in the United States. Building upon academic research from related areas, this Article has sought to develop a meaningful framework for lenders to resolve distressed agricultural loans more effectively. But this framework needs to be subjected to rigorous empirical analysis. For example, more empirical analysis of each of the

310. Lovallo & Sibony, *supra* note 1.

311. *See* CHIP HEATH & DAN HEATH, DECISIVE: HOW TO MAKE BETTER CHOICES IN LIFE AND WORK (1st ed. 2013).

312. *See id.*

traits of the key parties to a distressed loan would shed powerful insight into better predicting how a given party may act in a particular situation. Lenders would greatly benefit from a more thorough analysis of common cognitive errors that afflict banks—particularly when dealing with distressed loans.

Furthermore, academic research of the decision process at each hinge point should result in the fine tuning of decisions at each of those critical junctures. With respect to hinge 1 (underwriting) there is a need for academic research to identify what key factors or traits should guide lenders in turning down a loan when other less sophisticated lenders may be willing to make the loan. Hinge 2 (documenting the loan) would be benefitted by academic analysis as to how lenders can best eliminate loan documentation errors. Hinge 3 (early exit) could be improved by academic research as to acceptable, questionable, and risky levels for key ratios and other financial metrics. Lenders would also be benefitted by academic research that would help improve the ability to evaluate soft data. Hinge 4 (forbearance) is an area in great need of further research. Forbearance agreements happen frequently, yet, because they are private, they are rarely discussed in either reported legal decisions or academic studies. Lenders would benefit if academic research could shed more light as to the timing and elements of a successful forbearance agreement. Hinge 5 (pursuing default remedies) would be benefitted through research as to what default remedies are most effective for particular collateral types. Hinge 6 (DIP financing) has a need for more clarity to help lenders identify when DIP financing is an acceptable risk and when doing so will dramatically increase the likelihood of a successful outcome. This is particularly true for smaller loans (less than $10 million) that are typically serviced by community banks who are not accustomed to DIP financing. Finally, hinge 7 (plan confirmation) would be benefitted by further analysis about what key actions lenders can take prior to plan confirmation to better position themselves such that the plan proves viable in the long term. In a nutshell, this Article has simply scratched the surface of the resolution of distressed agricultural loans. Much, much more remains to be done.