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Bankruptcy, the U.C.C. and the Farmer: PIK Payments –Heads “General Intangibles,” Tails “Proceeds

by

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Bankruptcy, the U.C.C., and the Farmer: PIK Payments—Heads “General Intangibles,” Tails “Proceeds” [*In re Schmaling*, 783 F.2d 680 (7th Cir. 1986)]

Direct government payments¹ to farmers² accounted for approximately 4.5% of the national gross farm income in 1983, and are projected to rise approximately 3% in 1986.³ In 1986, government payments will most likely surpass 1983's \$9.3 billion total.⁴ Out of this \$9.3 billion total, approximately \$5.2 billion was in the form of payment-in-kind (PIK) payments,⁵ diverting an estimated 80 million acres of farmland from crop production.⁶

In spite of these government payments, farmers have been experiencing financially difficult times,⁷ and many have no recourse but to turn to the Bank-

1. Direct government payments are either: (1) cash payments received from deficiency, diversion, disaster, storage, or other miscellaneous programs; or (2) payments-in-kind received from a diversion contract, under which the farmer receives a commodity in lieu of a cash payment. *Farm Income Update*, AGRIC. OUTLOOK, May, 1983, at 11, 12. See generally 1 J. JUERGENSMEYER & J. WADLEY, AGRICULTURAL LAW 245-80 (1982)(general discussion of government payment programs and their controversial nature); Fraas, *Federal Assistance Programs for Farmers: An Outline for Lawyers*, 1981-82 AGRIC. L.J. 405, 432-51 (discussion of price support programs); Frederick, *Federal Price and Income Support Programs for Agriculture—Some Alternatives*, 1980-81 AGRIC. L.J. 1 (discusses development of farm legislation on price and income support); Note, *Agricultural Financing Through Production Payments: Planning for Protection of Farmer and Lender*, 34 DRAKE L. REV. 515, 517-20 (1985)(role of government programs in agricultural sector).

2. As used in this comment, “farmer” is used in the general sense to mean an individual or entity involved in the production of agricultural products. See BLACK'S LAW DICTIONARY 546 (5th ed. 1979). “Farmer,” as defined in the Bankruptcy Code, is “a person that received more than eighty percent of his gross income . . . from a farming operation owned or operated by such person.” 11 U.S.C. § 101(17) (1982); see *In re White*, 238 F. Supp. 454 (D. Colo. 1965). “Failure over a period of years to receive any income from farming may indicate that the putative farmer is not really relying on farming as his primary source of income.” *Id.* at 456; *In re Beechwood*, 42 F. Supp. 401 (D.N.J. 1942). Lawyer who lived on family farm and was in charge of hired help but only received \$2,500 of income from the farm versus approximately \$10,000 from his law business was not a farmer. *Id.* at 403; *In re Peters*, 60 Bankr. 711, 713 (Bankr. D. Minn. 1986)(although debtor not presently engaged in farming, intending to resume full-time farming held sufficient); *In re Cattle Complex Corp.*, 54 Bankr. 50, 51 (Bankr. D.N.M. 1985)(debtor who operated feedlot held as farmer); see also 1 COLLIER ON BANKRUPTCY ¶ 4.15[1] (14th ed. 1974)(comprehensive analysis of the term farmer). “Farming operation,” includes “farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.” 11 U.S.C. § 101(18) (1982). The legislative history of 11 U.S.C. § 101(18) (1982) indicates the term “farming operation” should be given a broad interpretation. 124 CONG. REC. S17,406-07 (daily ed. Oct. 6, 1978). For an in-depth analysis of the legislative history of the definition, see *In re Blanton Smith Corp.*, 7 Bankr. 410 (Bankr. M.D. Tenn. 1980); and 2 COLLIER ON BANKRUPTCY ¶ 101.18 (15th ed. 1985)(§ 101(18) not limited to precise terms listed).

3. *Farm Income*, AGRIC. OUTLOOK, March, 1986, at 14, 16 (results of study compiled in line graph for the period 1960-86).

4. *Id.* at 16. If there is severe weather during the 1986 growing year, such as hail, damaging wind, or rain, government outlays to the farmer will be increased beyond the projected amount. *Id.*

5. *Id.* For information on the PIK program, see *infra* notes 45-54.

6. *Review of the Payment-In-Kind Program: Joint Hearing Before Subcomm. on Cotton, Rice, and Sugar and the Subcomm. on Wheat, Soybeans, and Feed Grains of the House Comm. on Agriculture*, 98th Cong., 1st Sess. 5 (1983)(statement of Rep. Roberts)[hereinafter cited as *Hearing on PIK Program*]. The 80 million acres of farmland represented over 81.1% of the total farmland available for use under the PIK program. *Id.*

7. See generally *Consecutive-Disaster Emergency Loan Act of 1984 and General Issues Relating to Agricultural Credit, 1984: Hearing on H.R. 4610 Before Subcomm. on Conservation, Credit and Rural Development of the House Comm. on Agriculture*, 98th Cong., 2d Sess. 1, 7 (1984)(statement of Rep. Robert Lindsay Thomas)[hereinafter cited as *Hearing on H.R. 4610*](farm debt has “doubled

ruptcy Code for relief.⁸ With farm income declining⁹ and farm bankruptcies rising,¹⁰ creditors are scrambling to perfect security interests¹¹ for which crops¹²

and tripled in the past three to four years"); *Toward the Next Generation of Farm Policy: Hearings Before the Joint Economic Comm. and the Subcomm. on Agriculture and Transportation of the Joint Economic Comm.*, 98th Cong., 1st Sess. 14 (1983)(statement of Secretary of Agric., John R. Block). Over the past several years a number of factors including worldwide recession and the Soviet grain embargo have had a dampening effect on the farm economy. *Id.*; The "economic deterioration of the farm sector" is seen as a future problem. *Id.* at 148, 155 (statement of Sen. Jepsen); ECON. RESEARCH SERV., USDA, *THE CURRENT FINANCIAL CONDITION OF FARMERS AND FARM LENDERS 1-5* (1985)(in-depth analysis of causes of current farm crisis); E. MELICHAR & M. WALDHEGER, *AGRICULTURAL FINANCE DATABOOK, ANNUAL SERIES* (1979). Outstanding non-real estate farm debt grew from \$11.5 billion in 1960 to \$70.3 billion in 1980. *Id.*; *Agricultural Economy*, AGRIC. OUTLOOK, April, 1985, at 2. "Persistent cash-flow problems weaken the ability of many farmers to service their debts, and the decline in their farm asset values make it hard for them to access operating credit." *Id.*; Harl, *The Architecture of Public Policy: The Crisis in Agriculture*, 34 U. KAN. L. REV. 425 (1986). Unless something drastic is done, more than one-third of the nation's farmers will become insolvent within three to four years. *Id.* at 430; Heitz, *Financing Agricultural Land Purchases in the 1980's*, 1981-82 AGRIC. L.J. 697, 697 (farm debt doubled in the 1950's and 60's and tripled in the 70's); Thompson, *Farm Financial Distress: Nature, Scope and Measurement of the Problem*, 4 AGRIC. L.J. 450 (1983)(discussion of the financial condition of farmers); cf. Shepard & Collins, *Why Do Farmers Fail?, Farm Bankruptcies 1910-78*, 64 AM. J. AGRIC. ECON. 609, 612 (1982)(since World War II, no evidence that agricultural support payments have "induced, deferred, or reduced farm failures").

8. *Hearing on H.R. 4610, supra* note 7, at 7. All references to the "Bankruptcy Code" contained herein are to the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978)(codified as amended at 11 U.S.C. §§ 101-151326 and scattered sections of 28 U.S.C. (1982 & Supp. II 1984 & Supp. III 1985)). See generally *In re Lawrence*, 41 Bankr. 36, 38 (Bankr. D. Minn. 1984)(Bankruptcy Code was not drafted with farmers in mind); ECON. RESEARCH SERV., USDA, *AGRICULTURAL FINANCE: OUTLOOK AND SITUATION 6-7*, table 5 (Dec. 1983)(extent of financial stress in agriculture by region and by type of farming area); Baker, *Structural Issues in U.S. Agriculture and Farm Debt Perspectives*, 34 U. KAN. L. REV. 457, 459-64 (1986)(proposals for reduction in the current financial stress of farmers); Kunkel, *Farmers' Relief Under the Bankruptcy Code: Preserving the Farmers' Property*, 29 S.D.L. REV. 303, 303 (1984)("record numbers of farmers are seeking protection under the Bankruptcy Code"); Lander, *Is the Agricultural Security Interest Legally Healthy?*, 34 U. KAN. L. REV. 505, 509-18 (1986)(general discussion of problems confronting a secured creditor when a borrower moves to bankruptcy); Knudsen, *Last Chance for the Family Farmer?*, Topeka Capital J., July 13, 1986, at 32, col. 1 (number of Kansas farm bankruptcies represented in chart by county). For material which discusses farmers' alternatives to bankruptcy and effect on creditors, see Meyer, *Issues Concerning a Farmer's Alternatives to Bankruptcy*, 7 J. AGRIC. TAX'N & L. 272, 275-76 (1985); and Comment, *Bankruptcy: Can It Save the Family Farm?*, 11 WM. MITCHELL L. REV. 1019 (1985).

9. *Farm Income*, AGRIC. OUTLOOK, March, 1986, at 14. Net farm income, the income generated during a given calendar year, is expected to decline for the second consecutive year, from \$29-\$34 billion anticipated in 1985 to \$18-\$21 billion anticipated in 1986. *Id.*; cf. Richards, *A Farmer's View of the Legal Profession and the Family Farm of Tomorrow*, 34 U. KAN. L. REV. 651, 653 (1986)(present crisis was not caused by farmer's lack of income, but by debt and liquidity problems). But see ASCS, USDA, *WHY FARM PROGRAMS?* 2 (Aug. 1979). Stability is needed to assure farmers an income in the market and the flexibility to determine which crops to plant, considering efficiency and financial return. *Id.*

10. See generally *Long-Term Farm Policy to Succeed the Agriculture and Food Act of 1981 (Conservation and Credit Programs): Hearings Before Subcomm. on Conservation, Credit, and Rural Development of the House Comm. on Agriculture*, 98th Cong., 2d Sess. 249, 251 (1984)(testimony of Daniel Levitas on behalf of Rural American Organization). With financial stress among farmers at a crisis level, "approximately 130 to 150 farmers are forced out of farming weekly." *Id.* In extreme cases, some farmers face forced liquidation, foreclosure, and bankruptcy. *Agricultural Economy*, AGRIC. OUTLOOK, April, 1985, at 2. Farmers with debt equalling 40% to 70% of assets are in serious financial difficulty. *Financial Conditions of Farmers*, AGRIC. OUTLOOK, April, 1985, at 27, 28 (results of study compiled into bar chart). It appears that due to farmers' ever-increasing debt, farm bankruptcy filings will increase in number in the foreseeable future. Bland, *Insolvencies in Farming and Agri-business*, 73 KY. L.J. 795, 800 (1985).

11. A "security interest" is an "interest in personal property or fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(37) (1977). See also U.C.C. § 9-105(1)(f) (1977)(a security agreement is an agreement that "creates or provides for a security interest"). Note an

and other farm tangibles¹³ serve as collateral.¹⁴ The farmer's participation in a government production program¹⁵ poses a problem if security agreements¹⁶ are

"agreement" is not necessarily the parties' "contract." Compare U.C.C. § 1-201(3) (1977)(definition of agreement) with § 1-201(11) (1977)(definition of contract).

"Perfected" means that the secured party has taken all the steps required by Article Nine for perfection. "A perfected security interest may still be or become subordinate to other interests but in general after perfection the secured party is protected against creditors and transferees of the debtor and in particular against any representative of creditors in insolvency proceedings instituted by or against the debtor." U.C.C. § 9-303 comment 1 (1977). The general rule under Article Nine is that to perfect a security interest, a financing statement must be filed. See U.C.C. § 9-302(1) & comment 1 (1977); see also U.C.C. § 9-402 (1977)(formal requisites of a financing statement); U.C.C. § 9-401(1) (1977)(where financing statement must be filed). For the steps required to perfect a security interest, see U.C.C. §§ 9-302 to -306 (1977). For a discussion of the creation and perfection of a security interest, see REILEY, *GUIDEBOOK TO SECURITY INTERESTS IN PERSONAL PROPERTY* § 3.1-8, at 3-1 (1981); Meyer, *Potential Problems Connected With the Use of "Crops" as Collateral for Article 9 Security Interests*, 1981-82 AGRIC. L.J. 115, 132-37; see also Rasor & Wadley, *The Secured Farm Creditor's Interest in Federal Price Supports: Policies and Priorities*, 73 KY. L.J. 595, 598 (1985)(filing, the most common means of perfection, is normally used when the collateral is farm products such as crops); cf. Rosentrater, *Protecting the Lender's Rights When Farmers File for Bankruptcy*, 29 S.D.L. REV. 333, 339-44 (1984)(debtor and trustee are given considerable powers to avoid or impair the security interest of the lender); Note, *Secured Interests in Growing and Future-Growing Crops Under the Uniform Commercial Code*, 49 IOWA L. REV. 1269, 1286-87 (1964)(special protection is given to holder of a security interest in crops).

12. "The term 'crops' is nowhere defined in the Code [U.C.C.]. It appears, however, to have been used as a term of broad reference to anything that is vegetable, as distinguished from animal or mineral." 2 G. GILMORE, *SECURITY INTEREST IN PROPERTY* § 32.4, at 863 (1965); see U.C.C. § 9-105 & comment 1 (1977). Pursuant to U.C.C. § 9-109(3) (1977), the term "farm products" includes "crops . . . as well as the product of [crops] . . . not subject to a manufacturing operation." 2 G. GILMORE, *supra*, § 26.6, at 694; see also B. CLARK, *THE LAW OF SECURED TRANSACTIONS UNDER THE U.C.C.*, § 8.5[1][a], at 8-47 (1980); Clark, *The Agricultural Transaction: Equipment and Crop Financing*, 1979-80 AGRIC. L.J. 172, 187-93 (problems of priority among creditors when crops are collateral); Meyer, *Potential Problems Connected With the Use of "Crops" as Collateral For an Article 9 Security Interest*, 1981-82 AGRIC. L.J. 115, 137 (impact of U.C.C. on problems involving crops as collateral); Meyer, *"Crops" as Collateral for an Article 9 Security Interest and Related Problems*, 15 U.C.C. L.J. 3, 18 (1982)("financing statement has to include a real estate description whenever growing crops or crops to be grown are involved"); Note, *Mortgages on Future Crops as Security for Government Loans*, 47 YALE L.J. 98, 104 (1937)(crop and land mortgage liens attach simultaneously upon planting the crop).

13. "Tangibles" refer to property such as tractors or farm implements which can be seen or touched. See BLACK'S LAW DICTIONARY 1305 (5th ed. 1979).

14. See Hershner & Boyer, *The Farmer in Distress—Can Bankruptcy Help?*, 1985 ANN. SURV. BANKR. L. 177, 203. Farmers rely heavily on financing to operate their farms. *Id.*; see also Shanor, *A New Deal for Secured Creditors in Bankruptcy*, 28 EMORY L.J. 587, 620-21 (1979)(creditor rights after debtor files a petition for bankruptcy); Note, *The Farm Creditor: Preserving Security Interests in Farm Products*, 33 DRAKE L. REV. 391 (1984)(problems arise when debtor sells crops and does not remit proceeds from sale to creditor).

Collateral is "the property subject to a security interest, and includes accounts and chattel paper which have been sold." U.C.C. § 9-105(1)(c) (1977); see also BLACK'S LAW DICTIONARY 237 (5th ed. 1979)(definition of collateral). Under Article Nine, "any description of [collateral] is sufficient whether or not it is specific, if it reasonably identifies what is described." U.C.C. § 9-110 (1977).

15. Government price support programs include PIK, milk diversion, sugar subsidy, low-yield disaster, deficiency, and wheat reserve programs. These farm programs are authorized by the farm bill which is amended by Congress every four years. Present programs are implemented under the authority of the Agricultural Act of 1949, 7 U.S.C. § 1421 (1982 & Supp. III 1985), as amended by Agriculture and Food Act of 1981, 7 U.S.C. § 1444d (1982 & Supp. III 1985). The basic provisions for these programs are governed by the Agriculture and Food Act of 1982, Pub. L. No. 97-253, 96 Stat. 768 (1982).

Congress has granted the United States Department of Agriculture (USDA) the power to implement government programs. The Agricultural Act of 1949, 7 U.S.C. §§ 1421-49 (1982), as amended by Soil and Conservation and Domestic Allotment Act, 16 U.S.C. §§ 590a-590g (1982). The programs are administered by the Commodity Credit Corporation (CCC), authorized under 62 Stat. 1070 (1948)(codified at 15 U.S.C. § 714 (1982 & Supp. III 1985)), and by the Agricultural Stabilization and Conservation Service (ASCS), authorized under 16 U.S.C. § 590h(b) (1982 & Supp. III 1985). The CCC and the farmer enter into a contract, under which the farmer agrees to abide by

not specifically drafted to give creditors a security interest in the payments received from government programs.¹⁷ In *In re Schmalig*,¹⁸ the court holds that corn received under the PIK program did not constitute crop "proceeds" under Article Nine of the Uniform Commercial Code (U.C.C.).¹⁹ The court reasons that PIK payments cannot be proceeds of a crop that was never planted.²⁰ The court further holds that the bank's security agreement failed to describe government entitlements, contract rights, or general intangibles as collateral; therefore, its security interest did not attach to the PIK payments.²¹

Creation of an enforceable security interest depends upon three requirements: (1) the lender must enter into a security agreement with the debtor or take possession of the collateral; (2) value must be given; and (3) the debtor must have rights in the collateral.²² A security interest can then be perfected to pro-

the rules and regulations of the CCC. 7 C.F.R. § 770.1(a) (1986). The ASCS carries out the programs through its county offices. See generally Hamilton, *Farmers' Rights to Appeal ASCS Decisions Denying Farm Program Benefits*, 29 S.D.L. REV. 282, 283-90 (1984)(discussion of producer-government relationship in agricultural price support programs); Wadley, *Small Farms: The USDA, Rural Communities and Urban Pressures*, 21 WASHBURN L.J. 478, 481-84 (1982)(USDA program effects on farming); ASCS, USDA, ASCS Background Info. No. 1 (1976)(general discussion of USDA regulations on the ASCS).

The milk diversion program, administered by the CCC, pays farmers a subsidy for contracting to decrease their milk production. Agriculture & Food Act of 1981, Pub. L. No. 97-98, §§ 103, 106, 95 Stat. 1213 (1981). See generally ECON. RESEARCH SERV., USDA, AGRIC. INFO. BULLETIN NO. 474, DAIRY: BACKGROUND FOR 1985 FARM LEGISLATION 20 (1984)(general information on the current milk programs for farmers); Fraas, *Federal Assistance Programs for Farmers: An Outline for Lawyers*, 1981-82 AGRIC. L.J. 405, 445-46 (background information on the milk diversion program).

The wheat reserve program, now known as the farmer-owned grain reserve program, administered by the CCC, is for farmers who produce wheat and other grains. Its purpose is to keep grain off the market until a set target price level is reached in order to maintain commodity prices. A participating farmer must grant the CCC a security interest in all grain placed in the program. As long as the market price remains below the target price, the farmer is paid annually for storing the grain based on the number of bushels in storage. Agriculture and Food Act of 1981, Pub. L. No. 97-98, tit. X, 95 Stat. 1214 (1981). See generally CONG. RESEARCH SERV., REP. NO. 84-232, FEDERAL FARM PROGRAMS: A PRIMER 37-39 (1984)[hereinafter cited as CONG. RESEARCH SERV.].

16. For the definition of "security agreement," see *supra* note 11.

17. See generally Brake & Boehlje, *Solutions (or Resolutions) of Financial Stress Problems From the Private and Public Sectors*, 67 AM. J. AGRIC. ECON. 1123, 1123 (1986)(farmers and lenders are experiencing severe financial losses); Harl, *A Financial Revolution in Agriculture*, 60 N.D.L. REV. 387, 390-95 (1984)(discussion of problems in agricultural lending); Hershner & Boyer, *supra* note 14, at 178-80 (problems in drafting security agreements); Marsh, *Are PIK Payments Proceeds Under Article 9?*, 7 J. AGRIC. TAX'N & L. 291 (1986). "Creation and perfection of a security interest in PIK entitlements call for a precision that did not exist in some of the security agreements established before the [government] program was underway." *Id.* at 299.

18. 783 F.2d 680 (7th Cir. 1986).

19. *Id.* at 683. Article Nine of the U.C.C. covers secured transactions. "[T]he aim of this Article [Nine] is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty." U.C.C. § 9-101 comment (1977).

See UNIFORM COMMERCIAL CODE, 3 U.L.A. 1 (1981). Forty-four states have adopted Article Nine of the U.C.C. *Id.* Kansas adopted the U.C.C. in 1966. *Id.*; see also SELECTED COMMERCIAL STATUTES 801, 807-74, app. 1 (West 1985)(contains text of U.C.C. showing changes made in the former text and the reasons for the changes). See generally Coates, *Financing the Farmers*, 20 PRAC. LAW. 7, 45 (1974)(explanation of Article 9 provisions as they apply to farmers); Hawkland, *The Proposed Amendment to Article 9 of the U.C.C.—Part One: Financing the Farmer*, 76 COM. L.J. 416 (1971). Article Nine is the most radical, most studied, most amended and non-uniform section of the U.C.C. *Id.* at 420. By 1966, 337 amendments had been made to Article Nine alone. *Id.*

20. 783 F.2d at 683.

21. *Id.* at 681, 684.

22. U.C.C. § 9-203(1) (1977). For a discussion of when a security interest attaches, see J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE, § 23-2, at 902 (2d ed. 1980)[hereinafter cited as WHITE & SUMMERS]; see also *Holiday Rambler Corp. v. First Nat'l Bank and Trust*, 723

tect against other secured creditors and the trustee in bankruptcy²³ by complying with the U.C.C. provisions for perfection.²⁴

Even with an enforceable security interest, creditors are not totally protected. An essential determination to be made is whether government production payments received by a farmer after filing a petition for bankruptcy are subject to a security interest created before the filing of the petition.²⁵ An interpretation of the bankruptcy laws, the U.C.C., and the security agreement between the parties is required to resolve the issue.²⁶ Section 552(a) of the Bankruptcy Code states the general rule that an after-acquired property clause²⁷ in a security agreement executed before a petition for bankruptcy is filed is not enforceable in bankruptcy with respect to property received by the debtor after the petition is filed.²⁸ The exception to the rule is stated in section 552(b), under which a security interest created before a bankruptcy petition is filed remains enforceable as to proceeds the debtor receives after filing the petition.²⁹ For the

F.2d 1449, 1451 (10th Cir. 1983)(security interest does not attach until debtor has rights in collateral); First Nat'l Bank of Gaylord v. Autrey, 9 Kan. App. 2d 96, 98, 673 P.2d 448, 449 (1984)(absent any event of attachment, security interest is not perfected).

23. Generally, a trustee is a "person in whom the property of a bankrupt is vested in trust for creditors." BLACK'S LAW DICTIONARY 1357 (5th ed. 1979); see Bankruptcy Code, 11 U.S.C. § 321 (1982 & Supp. III 1985)(eligibility to serve as trustee); § 322 (1982 & Supp. III 1985)(qualifications of trustee); § 323 (1982)(role and capacity of trustee); § 701 (1982)(interim trustee); § 702 (1982 & Supp. III 1985)(election of trustee); § 704 (1982 & Supp. III 1985)(duties of trustee).

The trustee is also given powers under the Bankruptcy Code. See generally WHITE & SUMMERS, *supra* note 22, § 24-7, at 1017-19 (the role of the "strong arm provision" — § 544 of the Bankruptcy Code); Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 AM. BANKR. L.J. 173, 174-76 (1979)(trustee's avoidance powers under § 544 of the Bankruptcy Code).

24. U.C.C. § 9-301 comment 1 (1977); see *supra* note 11 (discussion on perfection of security interests). Intangible personal property, i.e., accounts and general intangibles, cannot be possessed. Therefore, a written security agreement is required under U.C.C. § 9-203(1) (1977). Also, since accounts or general intangibles cannot be possessed, perfection of such interests requires the filing of a financing statement. U.C.C. § 9-305 comment 1 (1977). *But see* U.C.C. § 9-302(1) (1977) which "exempts from filing certain assignments of accounts which are out of the ordinary course of financing . . ." U.C.C. § 9-305 comment 1 (1977). In most secured transactions, the debtor has possession of the collateral; therefore, a written agreement is required. Property in the form of accounts or general intangibles cannot be possessed because it is not "represented by a writing whose delivery operates to transfer the claim." U.C.C. § 9-305 comment 1 (1977).

25. See generally Shapiro, *Section 552—Postpetition Effect of Security Interests*, 1985 ANN. SURV. BANKR. L. 623, 623-28 (discussion of effect of security interests created before and after a petition for bankruptcy is filed).

26. Shapiro, *supra* note 25, at 629. See generally Riley, *Farming Failures and Drafting Failures: The Uncertain Posture of Crop Financing Under Article 9 and § 547 of the Bankruptcy Code*, 1983 ANN. SURV. BANKR. L. 29 (general discussion of security interest attachment to goods acquired after a petition in bankruptcy is filed).

27. "A security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." U.C.C. § 9-204(1) (1977). "A security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement." U.C.C. § 9-204 comment 1 (1977). Any reference to an after-acquired property clause should be included in the security agreement, not the financing statement. U.C.C. § 9-204 comment 5 (1977). See generally Cohen & Gerber, *The After-Acquired Property Clause*, 87 U. PA. L. REV. 635 (1939)(general discussion of after-acquired property clauses).

28. 11 U.S.C. § 552(a) (1982) states, "Except as provided in subsection (b) of this section, property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."

29. 11 U.S.C. § 552(b) (1982 & Supp. II 1984) provides:

"[I]f the debtor and a secured party enter into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds,

farmer, what section 552(a) grants, section 552(b) may take away.³⁰

In farm bankruptcy cases, an issue which must be addressed is whether government production payments are within the scope of a secured creditor's security agreement.³¹ Resolution of this issue turns on: (1) whether the government production payment is classified under Article Nine of the U.C.C. as "proceeds"³² of crops or as a "general intangible",³³ and (2) whether the farmer

product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable bankruptcy law, except to the extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise."

Id.; § 552(b) was later amended. 11 U.S.C. § 552(b) (Supp. III 1985).

The last clause of § 552(b) gives the court discretion, based on the equities of the case, to avoid a security interest created by a secured party. 4 COLLIER ON BANKRUPTCY ¶ 552.02 (15th ed. 1983). This exception may be made where the estate has invested monies to enhance the value of the collateral. *Id.* The equity exception to § 552(b) is meant for cases where the trustee or debtor in possession uses other assets of the bankruptcy estate, i.e., assets that would otherwise go to general creditors, to increase the value of the collateral. *In re J. Catton Farms, Inc.*, 779 F.2d 1242, 1245 (7th Cir. 1985); see also *In re Lawrence*, 41 Bankr. 36 (Bankr. D. Minn. 1984). The court held that § 552(b) was intended to be a narrow exception to § 552(a) and was not intended to apply to milk products or milk proceeds acquired after the bankruptcy petition was filed, irrespective of whether the creditor had a perfected security interest. *Id.* at 37-38.

30. In many agricultural cases, the security agreement will include the items covered in § 552(b). See 124 CONG. REC. H11,097-98 (daily ed. Sept. 28, 1978).

When a farmer's income is derived from products in the farming operation and the proceeds from such products, the farmer's income stream is cut off because the proceeds are cash collateral. Absent authority from the bankruptcy court to use the cash collateral, the farmer may not use it and has no money to pay for operating expenses.

Id. For provisions adding to the definition of cash collateral which are subject to a security interest under § 552(b), see 11 U.S.C. § 363(a) (1982 & Supp. III 1985); and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 442, 98 Stat. 333, 371-72 (1984).

31. Hershner & Boyer, *supra* note 14, at 198. Determining the amount of a creditor's secured claim in bankruptcy involves a three-step analysis: (1) whether the debtor's property is covered by the creditor's security agreement; (2) if so, whether the security agreement is perfected; and (3) the value of the collateral itself. *Id.*

32. "Proceeds" include "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." U.C.C. § 9-306(1) (1977). For cases holding that government production payments are "proceeds," see *In re J. Catton Farms, Inc.*, 779 F.2d 1242, 1245 (7th Cir. 1985)(PIK payments); *In re Munger*, 495 F.2d 511, 512-13 (9th Cir. 1974)(abandonment and subsidy payments); *Apple v. Miami Prod. Credit Ass'n*, 614 F. Supp. 119, 123 (D.C. Ohio 1985)(PIK payments); *Osteros v. Norwest Bank Minot*, 604 F. Supp. 848, 849 (D.N.D. 1984)(PIK payments); *In re Bechtold*, 54 Bankr. 318, 321 (Bankr. D. Minn. 1985)(milk production payments); *In re Kelley*, 53 Bankr. 961, 963 (Bankr. W.D. Ky. 1985)(PIK payments); *In re Hollie*, 42 Bankr. 111, 122 (Bankr. M.D. Ga. 1984)(milk production payments); *In re Judkins*, 41 Bankr. 369, 372 (Bankr. M.D. Tenn. 1984)(PIK payments); *In re Cupp*, 38 Bankr. 953, 955 (Bankr. E.D. Wash. 1984)(PIK payments); *In re Lee*, 35 Bankr. 663, 666-67 (Bankr. N.D. Ohio 1983)(PIK payments); *In re Cawthorn*, 33 Bankr. 119, 120 (Bankr. M.D. Tenn. 1983)(milk production payments); *In re Preisser*, 33 Bankr. 65, 67 (Bankr. D. Colo. 1983)(PIK payments); *In re Nivens*, 22 Bankr. 287, 291 (Bankr. N.D. Tex. 1982)(cotton deficiency payments); and *First Nat'l Bank v. Milford*, 239 Kan. 151, 158, 718 P.2d 1291, 1297 (1986)(PIK payments).

33. "General intangible" is a classification of collateral which includes "any personal property other than goods, accounts, chattel paper, documents, instruments, and money." U.C.C. § 9-106 (1977). "'General intangibles' brings under [U.C.C. Article Nine] miscellaneous types of contractual rights and other personal property which are used or may become customarily used as commercial security." U.C.C. § 9-106 comment (1977). "General intangibles is a catchall category which may include funds received after execution of a security agreement. If the right to payment is not a right under a contract, it cannot be an account but must be a general intangible." WHITE & SUMMERS, *supra* note 22, § 22-8, at 893.

For cases holding that government production payments are "general intangibles," see *In re Sabelka*, 57 Bankr. 972, 974 (Bankr. N.D. Iowa 1986)(PIK payments); *In re Lions Farms, Inc.*, 54 Bankr. 241, 244 (Bankr. D. Kan. 1985)(PIK payments); *In re Frasch*, 53 Bankr. 89, 90 (Bankr. D.S.D. 1985)(milk production payments); *In re Mattick*, 45 Bankr. 615, 617 (Bankr. D. Minn. 1985)(PIK payments); *In re Binning*, 45 Bankr. 9, 12 (Bankr. S.D. Ohio 1984)(PIK payments); *In re*

entered into the government contract before or after the bankruptcy petition was filed.³⁴ These critical questions have been inconsistently resolved by the courts.³⁵

The line of cases classifying government production payments as proceeds³⁶ originated with *In re Munger*³⁷ in 1974. The debtor, a sugar beet farmer, granted the Production Credit Association (PCA) a security interest in "the crops to be grown . . . and proceeds or products from these crops."³⁸ Three years later, the PCA sought additional security from the debtor, who assigned the subsidy payments due under his sugar beet production adjustment contract.³⁹ The debtor then abandoned his crop because of disease and sought abandonment payments from the government.⁴⁰ After the debtor filed a petition

Liebe, 41 Bankr. 965, 967 (Bankr. N.D. Iowa 1984)(PIK payments); *In re Fowler*, 41 Bankr. 962, 964 (Bankr. N.D. Iowa 1984)(PIK payments); *In re Connelly*, 41 Bankr. 217, 221 (Bankr. D. Minn. 1984)(wheat reserve payments); *In re Schmidt*, 38 Bankr. 380, 383 (Bankr. D.N.D. 1984)(PIK payments); *In re Barton*, 37 Bankr. 545, 547 (Bankr. E.D. Wash. 1984)(PIK payments); *In re Kruse*, 35 Bankr. 958, 965 (Bankr. D. Kan. 1984)(PIK payments); and *In re Sunberg*, 35 Bankr. 777, 783-84 (Bankr. S.D. Iowa 1983)(PIK payments), *aff'd*, 729 F.2d 561 (8th Cir. 1984).

34. *Hershner & Boyer*, *supra* note 14, at 201. Regardless of the collateral's classification, the validity of a security interest in after-acquired property is determined by the bankruptcy laws. See 11 U.S.C. § 552(a), (b) (1982 & Supp. III 1985). For example, a security interest in after-acquired crops, even if created before bankruptcy, will not attach to crops planted after the commencement of the bankruptcy action, since such crops are deemed to have been "acquired" after the commencement of bankruptcy. See *In re Sheehan*, 38 Bankr. 859, 863 (Bankr. D.S.D. 1984)(security interest created before bankruptcy petition filed did not extend to after-acquired property); *In re Hamilton*, 18 Bankr. 868, 871 (Bankr. D. Colo. 1982)(§ 552 governs the effect of a security interest in after acquired property).

However, in the case of crops planted before the filing of the bankruptcy petition, the creditor's security agreement will protect its interest since the security interest in crops attaches when the crops are planted. *In re Kruse*, 35 Bankr. 958, 965 (Bankr. D. Kan. 1984); see also *First Nat'l Bank v. Milford*, 239 Kan. 151, 158, 718 P.2d 1291, 1297 (1986)(PIK payments held to be proceeds of a planted crop).

35. See generally *Marsh*, *supra* note 17, at 300; Note, *Agricultural Financing Through Production Payments: Planning for Protection of Farmer and Lender*, 34 *DRAKE L. REV.* 515 (1985). The courts have classified PIK payments as a substitute for crops, contract rights, proceeds of crops, accounts, general intangibles, and rent and profits of real estate. *Id.* at 522-23. The courts have also been perplexed when farmers have not been approved for participation in the government program at the time the bankruptcy petition was filed, or if the government program was not yet in existence at the time the security agreement was executed. *Id.* at 521. If the government payments have not yet been received by the farmer or approved by the CCC, creditors must use an after-acquired property clause to extend the security interest to include property acquired after the security agreement was executed. *Id.* For a discussion of after-acquired property clauses in security agreements, see *supra* note 27.

36. For a definition of "proceeds" and cases holding that government production payments are proceeds, see *supra* note 32. For a discussion of cases treating PIK payments as proceeds, see *infra* notes 37-44 and 59-82 and accompanying text.

37. 495 F.2d 511 (9th Cir. 1974).

38. *Id.* at 512.

39. *Id.* The subsidy payments from the USDA under the contract were designed to protect the U.S. sugar industry and the welfare of sugar beet producers. The debtor, by assignment of his contract rights, agreed to give the PCA all subsidy payments received for harvested and non-harvested crops. *Id.*

40. *Id.* The court stated that the abandonment payments for the sugar beet crop resembled insurance proceeds under U.C.C. § 9-306(1) (1977). 495 F.2d at 513. Abandonment payments were based on a minimum standard for the sugar content of the crop. 7 U.S.C. §§ 1131-33 (expired Dec. 31, 1974). Current legislation for the sugar program is contained in the Agriculture and Food Act of 1981, Pub. L. No. 97-98, tit. IX, 95 Stat. 1214 (1981). The court stated the PCA should have been aware of the existence of subsidy payments for sugar beet farmers. 495 F.2d at 513; *cf.* *Quigley v. Caron*, 247 A.2d 94 (Me. 1968)(insurance payments for crop casualty were held not to be proceeds of crop).

for bankruptcy, the bankruptcy trustee⁴¹ claimed the subsidy and abandonment payments as property of the bankruptcy estate.⁴² The Ninth Circuit Court of Appeals held the abandonment and subsidy payments to be proceeds.⁴³ The court determined that the government payments resulted from crops that were already planted; therefore, the PCA was entitled to the payments as proceeds of the planted crop.⁴⁴

In 1983, with farmers facing the likelihood of a fourth consecutive year of reduced farm income and a continued cost-price squeeze,⁴⁵ regulations for the PIK program were announced.⁴⁶ The PIK program is a voluntary land diversion program for wheat, corn, sorghum, upland cotton, extra long staple cotton, and rice crop farmers.⁴⁷ Designed to minimize production, avoid increased gov-

41. For a discussion of the bankruptcy trustee, see *supra* note 23.

42. 495 F.2d at 512. Property of the estate includes "all legal or equitable interests of the debtor in property" at the time the petition in bankruptcy is filed. 11 U.S.C. § 541(a)(1) (1982 & Supp. III 1985). Also included are any "proceeds, products, offspring, rents, or profits of or from the property of the estate." 11 U.S.C. § 541(a)(6) (1982 & Supp. III 1985).

43. 495 F.2d at 512-13.

44. *Id.* at 513; see *In re Nivens*, 22 Bankr. 287 (Bankr. N.D. Tex. 1982). The court held cotton deficiency, low-yield and disaster payments to be direct substitutes for a failed crop and the payments were classified as proceeds. *Id.* at 291. For regulations on the cotton program, see 7 U.S.C. § 1444 (1982 & Supp. III 1985); and 7 C.F.R. pt. 713 (1986).

45. *Hearing on PIK Program*, *supra* note 6, at 22 (statement of Asst. Secretary of Economics, William G. Leshner).

46. Legislative authority for the PIK program includes the Agricultural and Food Act of 1981, the Omnibus Budget Reconciliation Act of 1982, and the Commodity Credit Corporation Charter Act. The rules creating the PIK program were published in interim form on January 10, 1983, and in final form on February 28, 1983. See 48 Fed. Reg. 1,476 (Jan. 12, 1983)(interim form); 48 Fed. Reg. 9,232 (Mar. 4, 1983)(final form) (codified at 7 C.F.R. pt. 770 (1986)). The PIK program was promulgated under the authority of the Agricultural Act of 1949, ch. 792, 63 Stat. 1051 (1949)(codified as amended at 7 U.S.C. §§ 1441-1445h (1982 & Supp. III 1985)), and the Commodity Credit Corporation Charter Act, ch. 704, 62 Stat. 1070 (1948)(codified at 15 U.S.C. §§ 714-715m (1982 & Supp. III 1985)).

For a discussion of the PIK program, see Marsh, *supra* note 17, at 296-300. "PIK was developed to supplement already existing acreage reduction programs." *Id.* at 297; Marten, *Seven PIKs to Ponder for '86*, FARM J., Jan. 1986, at 6 (explanation of the different PIK programs); Suber, *PIK Effects Spread, Kansas RFD*; Topeka Capital J., Apr. 8, 1983, at 9, col. 4 (PIK program's impact on Kansas agriculture); cf. *Hearing on PIK Program*, *supra* note 6, at 142-44 (statement of Exec. Dir. of Comm. on Nutrition Institute, Rodney E. Leonard)(discussion about PIK program going in the wrong direction); Kinney, *For Full Production on the Farm*, Wall St. J., June 17, 1985, at 20 (adverse effects of PIK program on agribusiness).

PIK was tried briefly in the 1930's with cotton, and again in 1961 in a one-year program covering feed grains. Farmers were required to take a certain amount of crop acreage out of production in order to qualify. The program was renewed in 1962 and remained in effect until 1970. *PIK Programs of the 1960's*, AGRIC. OUTLOOK, May, 1983, at 25, 26. The PIK program was again instituted in 1983 and remains effective today. 49 Fed. Reg. 2,227 (Jan. 19, 1984). As of February 1, 1986, farm programs use a "generic PIK" certificate under which the USDA issues PIK certificates partially in lieu of cash payments. The certificate is not commodity specific, but carries a dollar amount due the farmer. K. Meyer, *Secured Transactions in Agriculture 19-20* (Feb. 27, 1986)(CLE seminar Salina & Ottawa counties in Kansas). "Generic" PIK certificates are being used to redeem grain destined for forfeiture, thereby putting the grain back on the market. *Profit Management*, 49 DOANE'S AGRIC. REP., July 25, 1986, at 30-5. "Under the 1985 farm bill, the USDA is required to pay farmers for 2.5% of the land they are required to idle this year." K. Meyer, *supra*, at 19-20.

PIK was perceived as the largest government acreage reduction program in the history of the U.S. *Hearing on PIK Program*, *supra* note 6, at 10 (statement of Secretary of Agric., John R. Block).

For a discussion of tax and security interest concerns associated with PIK, see Deaner, *Protecting a Lender's Security Interest in PIK Collateral*, 5 J. AGRIC. TAX'N & L. 107 (1983); Harl, *New Legislation to Solve Payment-In-Kind Woes*, 5 J. AGRIC. TAX'N & L. 3 (1983); and Harris, *Taxation of PIK Assignments*, 5 J. AGRIC. TAX'N & L. 291 (1983).

47. 7 C.F.R. § 770.1(b) (1986); cf. *Kasick v. Block*, 717 F.2d 459 (8th Cir. 1983)(PIK program held not to include popcorn).

ernment outlays, and reduce government surpluses,⁴⁸ the PIK program allows farmers to idle productive acreage by entering into a binding, irrevocable contract with the Commodity Credit Corporation (CCC) in return for payment in the form of the commodity diverted.⁴⁹ Farmers who contract to participate in the PIK program have two alternatives: (1) devote a percentage of the farm's acreage base⁵⁰ to conservation, with a commensurate reduction in unplanted acreage;⁵¹ or (2) devote 100% of the farm's acreage base to conservation.⁵² The farmer also agrees to use good soil conservation techniques, to keep weeds under control, and where economical, to plant a ground cover crop which may not be grazed or harvested during the growing season.⁵³ In return, the farmer receives a PIK payment based on a fixed percentage which varies according to the specific crop diverted.⁵⁴

Following implementation of the PIK program, some courts applied the *Munger* reasoning in cases involving PIK program receipts. The cases addressed assignments of PIK rights,⁵⁵ exemptions of PIK payments in bank-

48. *PIK Programs of the 1960's*, AGRIC. OUTLOOK, May, 1983, at 25.

49. See generally Hershner & Boyer, *supra* note 14, at 201. The quantity of the commodity to which the participating farmer is entitled is determined by multiplying the established base acreage of the crop diverted by the established yield for the farm. 7 C.F.R. § 770.3(a)(1) (1986); see *In re Kruse*, 35 Bankr. 958, 962 (Bankr. D. Kan. 1984)(court set out computations in determining PIK payments). The commodity to be received is payable upon request during a five month period announced by the CCC. 7 C.F.R. § 770.3(a)(3) (1986). Commodities received from PIK generally are "CCC-owned stocks, farmer-owned reserve crops under regular loans, or a particular commodity." CONG. RESEARCH SERV., *supra* note 15, at 35. Payments are based on a fixed percentage for each farm commodity. The percentage is set by the Secretary of Agriculture and appears in the contract with the CCC. 7 C.F.R. § 770.3(a)(1) (1986). See generally USDA, AGRICULTURAL STATISTICS 1985 461, table 639 (Kansas ranks second, next to Texas, in receiving payments from ASCS for stabilization and conservation programs).

50. The crop acreage base is the average number of acres on which a farmer produced the crop to be diverted over a set period of years determined by the Secretary of Agriculture. 7 C.F.R. pt. 718 (1986); see also *In re Kruse*, 35 Bankr. 958, 961 (Bankr. D. Kan. 1983)(discussion of crop acreage base). The historical period for determining the crop acreage base is now set at five years. Shawnee County, Kansas ASCS Office, The Capital County Ag Review 1 (Feb. 24, 1986).

51. 7 C.F.R. § 770.2(a)(2)(i) (1986). This alternative is commonly referred to as "percentage of base PIK." Marsh, *supra* note 17, at 298.

52. 7 C.F.R. § 770.2(a)(2)(ii) (1986). "These contracts will be awarded on a competitive bid basis." Participants submit sealed bids specifying the percentage of the program yield that would be acceptable as compensation for participation in the program. The computation is based on the percentage of the established yield for each commodity which was bid by the farmer. *Id.* This alternative is commonly referred to as "whole base PIK." Marsh, *supra* note 17, at 298.

53. 7 C.F.R. § 770.1-3 (1986); see also *In re Sunberg*, 35 Bankr. 777, 779 (Bankr. S.D. Iowa 1983)(explanation of regulations of PIK program), *aff'd*, 729 F.2d 561 (8th Cir. 1984).

54. 7 C.F.R. § 770.5(b)(2) (1986).

55. Assignment of PIK rights is allowed under 7 C.F.R. § 770.6(e) (1986), as long as the assignment is made on Form CCC 479, "executed by the assignor and assignee, and filed with the county committee."

The purpose of this provision is not to affect the security interest, but merely to protect the government from liability for paying proceeds of the PIK contract to an unauthorized payee. Assignment of payment rights under PIK to secure any pre-existing indebtedness is forbidden by statute. Agricultural Act of 1949, § 105B(i)(codified as amended at 7 U.S.C. § 1444d(i) (1982)); Soil Conservation and Domestic Allotment Act § 8(g)(codified as amended at 16 U.S.C. § 590h(g) (1982)). For cases involving assignment of PIK rights, see *In re J. Catton Farms, Inc.*, 779 F.2d 1242, 1245 (7th Cir. 1985)(PIK payments subject to bank's security agreement; court held assignment not valid); *In re Judkins*, 41 Bankr. 369, 372 (Bankr. M.D. Tenn. 1984)(PIK payments subject to security interest as proceeds traceable to crops); *In re Cupp*, 38 Bankr. 953, 955 (Bankr. N.D. Ohio 1984)(since PIK payments are proceeds, assignment of PIK payments invalid); *In re Barton*, 37 Bankr. 545, 547 (Bankr. E.D. Wash. 1984)(PIK payments held as general intangible; no intent to include in security agreement); *In re Sunberg*, 35 Bankr. 777, 783-84 (Bankr. S.D. Iowa 1983)(PIK payment held as general intangible, included explicitly in PCA's security agreement), *aff'd*, 729 F.2d 561 (8th Cir.

ruptcy,⁵⁶ and attempts to invalidate security interests alleged to cover PIK payments.⁵⁷ These courts ignored the apparent distinction between farm subsidy programs, where crops are planted, and the PIK program, where there is usually no crop planted.⁵⁸

In *Osteroos v. Norwest Bank Minot*,⁵⁹ the debtors entered into a security agreement with a bank in 1982.⁶⁰ The security agreement covered "[a]ll farm products . . . whether owned or hereafter acquired, including but not limited to crops."⁶¹ The financing statement included the language, "the proceeds and products of such crops."⁶² In 1983, the debtors entered into the PIK program and received corn as payment, which they then sold to a third party; the debtors subsequently filed a petition for bankruptcy.⁶³ The bankruptcy court construed the PIK payments to be general intangibles.⁶⁴ The court held that the bank did not have a security interest in the PIK payments because the security agreement did not include general intangibles.⁶⁵ The United States District Court of North Dakota reversed, holding that the bank was entitled to the debtors' PIK payments because they were a substitute for corn that was subject to the bank's security agreement.⁶⁶ The court construed the language of the security agreement and the financing statement as sufficient to give the bank a security interest

1984); and *In re Preisser*, 33 Bankr. 65, 67 (Bankr. D. Colo. 1983)(PIK payment held as rents and profits of real estate subject to mortgage; assignment of PIK payments invalid).

56. To exempt property is to "relieve a certain class of property from liability or from taxation or disposition in bankruptcy, or attachment." BLACK'S LAW DICTIONARY 513 (5th ed. 1979). Exemption is a privilege allowed under certain circumstances. 11 U.S.C. § 522(b) (1982 & Supp. III 1985). For cases dealing with exemptions of PIK payments, see *In re Schmidt*, 38 Bankr. 380, 383 (Bankr. D.N.D. 1984)(PIK payment held as a general intangible and as exempt property under an executory contract); *cf. In re Lee*, 35 Bankr. 663, 666-67 (Bankr. N.D. Ohio 1983)(PIK payments held substitute for crops debtor would have planted; not exempt property).

57. Under 11 U.S.C. § 547(b)(4)(A), the trustee is given the power to recover payments and transfers to third parties made within ninety days preceding the filing of the bankruptcy petition. WHITE & SUMMERS, *supra* note 22, § 24-4, at 999-1007. For the definition of bankruptcy trustee, see *supra* note 23.

For cases regarding attempts to invalidate creditors' security interest in bankruptcy, see *Apple v. Miami Valley Prod. Credit Ass'n*, 614 F. Supp. 119, 123 (D.C. Ohio 1985)(PIK payments held as proceeds and subject to PCA's security agreement, defeating trustee); *Osteroos v. Norwest Bank Minot*, 604 F. Supp. 848, 849 (D.N.D. 1984)(PIK corn held as substitute for crops under bank's security agreement); *In re Lions Farms, Inc.*, 54 Bankr. 241, 244 (Bankr. D. Kan. 1985)(PIK payments were held as contract rights under an executory contract); *In re Mattick*, 45 Bankr. 615, 617 (Bankr. D. Minn. 1985)(security agreement did not attach to PIK payments that were held as general intangible); *In re Binning*, 45 Bankr. 9, 12 (Bankr. S.D. Ohio 1984)(without an after-acquired property clause, creditor has no security interest in PIK payments); *In re Liebe*, 41 Bankr. 965, 967 (Bankr. N.D. Iowa 1984)(security agreement did not grant creditor security interest in after-acquired PIK payments); *In re Fowler*, 41 Bankr. 962, 964 (Bankr. N.D. Iowa 1984)(PIK payment held as general intangible, but not subject to creditor's security interest); and *In re Kruse*, 35 Bankr. 958, 965 (Bankr. D. Kan. 1983)(PIK payment held as general intangible of crops not planted; but held as proceeds of crops that were growing).

58. Marsh, *supra* note 17, at 305.

59. 604 F. Supp. 848 (D.N.D. 1984).

60. *Id.* at 848.

61. *Id.*

62. *Id.* The financing statement covered "[a]ll crops or other plant products now planted, growing or grown, or which are hereafter planted or become growing crops and the proceeds and products of such crops." *Id.*

63. *Id.* at 848-49.

64. *Id.* at 849.

65. *Id.* The bankruptcy court relied on *In re Sunberg*, 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d at 561 (8th Cir. 1984). The *Sunberg* court held that PIK payments were general intangibles which the security agreement explicitly included. 35 Bankr. at 779.

66. 604 F. Supp. at 849.

in the PIK payments because the corn would have been grown had the debtor not entered the PIK program.⁶⁷

In *Apple v. Miami Valley Production Credit Association*,⁶⁸ the debtor executed a security agreement in 1977 with the PCA, covering crops and "all proceeds of the sale or other disposition [thereof] . . ." ⁶⁹ In March, 1983, the debtor executed a contract to participate in the PIK program and subsequently contracted to sell the PIK corn to an elevator.⁷⁰ The PCA brought suit in state court in July, 1983, seeking a money judgment and foreclosure of its mortgage on the debtor's real estate.⁷¹ In June, 1984, the debtor filed a petition for bankruptcy.⁷² The District Court of Ohio held that the PIK payments were proceeds of an unplanted crop and were therefore subject to the PCA's security interest.⁷³ The court stated that the PIK payments were generated from the agreement not to plant crops.⁷⁴

In 1985, in *In re J. Catton Farms, Inc.*,⁷⁵ the debtor had entered into a security agreement with a bank covering "receivables, accounts, inventory . . . and the proceeds and products thereof." ⁷⁶ The loan agreement defined "receivables" as accounts and contract rights, and "inventory" to include crops, whether harvested or growing.⁷⁷ The debtor entered into the PIK program in 1983 and shortly thereafter filed a petition for bankruptcy under Chapter 11 of the Bankruptcy Code.⁷⁸ Before receiving the PIK payments, the debtor as-

67. *Id.*; see *In re Judkins*, 41 Bankr. 369, 372 (Bankr. M.D. Tenn. 1984)(PIK payments held to be crop proceeds); *In re Cupp*, 38 Bankr. 953, 955 (Bankr. N.D. Ohio 1984)(PIK payments held to be product of crop); *In re Lee*, 35 Bankr. 663 (Bankr. N.D. Ohio 1983). In *Lee*, PIK payments were held to be a substitute for crops the debtor would otherwise have planted. Thus, the corn received by the debtor for complying with the PIK program was proceeds. *Id.* at 666-67.

68. 614 F. Supp. 119 (D.C. Ohio 1985).

69. *Id.* at 123.

70. *Id.* at 120. The elevator was to pay the debtor with four checks. The debtor argued that the elevator violated his constitutional rights by making the checks payable jointly to the debtor and to the PCA which held a security interest on the debtor's property. *Id.* at 123.

71. *Id.* at 120. The PCA foreclosed its mortgage before the debtor received the PIK payment. *Id.* Foreclosure refers to "enforcement of a lien, trust deed, or mortgage in any method provided by law." BLACK'S LAW DICTIONARY 581 (5th ed. 1979).

72. 614 F. Supp. at 120.

73. *Id.* at 123. For cases holding that PIK payments are merely substitutes for what the debtor would have grown had PIK not come into existence, see *In re Cupp*, 38 Bankr. 953 (Bankr. N.D. Ohio 1984)(the facts, including the security agreement language, were nearly identical to that in *Apple*); *In re Lee*, 35 Bankr. 663, 666-67 (Bankr. N.D. Ohio 1983)(PIK payments not exempt property); and *In re Preisser*, 33 Bankr. 65, 67 (Bankr. D. Colo. 1983)(PIK payments held as rents and profits of real estate subject to mortgage).

74. 614 F. Supp. at 123.

75. 779 F.2d 1242 (7th Cir. 1985).

76. *Id.* at 1244. The bank made a large loan to the debtor and wanted as much security as possible. *Id.* at 1245.

77. *Id.* at 1244.

78. *Id.* at 1245; see 11 U.S.C. §§ 1101-1146 (1982 & Supp. III 1985)(statutes pertaining to a petition for reorganization under Chapter 11). Most farmers look to reorganization under Chapter 11 bankruptcy. The farmer retains possession of the assets and operates the farm as a debtor in possession, and deals with the creditors under a plan of reorganization. The farmer must obtain the approval of at least one class of creditors to obtain the court's confirmation of his plan. In the plan, the farmer can restructure unsecured debt, short-term secured debt, and long-term secured debt. Despite its complexity, Chapter 11 is the primary option utilized by farmers, essentially because it permits the restructuring of long-term secured debt. 5 COLLIER ON BANKRUPTCY ¶ 1100.01 (15th ed. 1984); cf. Knudsen, *supra* note 8, at 32 (proposal in Congress for creation of a bankruptcy chapter just for farmers).

signed the payments as collateral for a loan from an elevator.⁷⁹ The Seventh Circuit Court of Appeals held that the bank's security agreement included the PIK payments as proceeds acquired after the debtor filed the petition for bankruptcy.⁸⁰ The debtor, by using the PIK payments to finance the planting of crops, subjected the crop proceeds to the PCA's security agreement.⁸¹ The court stated that even if contract rights or proceeds were not included in the security agreement, the bank's security interest in crops would have automatically given the bank a security interest in the proceeds of the sale of the crop.⁸²

In a second line of cases, payments under the PIK program have been held to be contract rights or general intangibles, and not proceeds.⁸³ The creditors' security interests in PIK payments in these cases did not attach absent a specific reference to a contract right, general intangible, or the PIK entitlement itself.⁸⁴ In *In re Sunberg*,⁸⁵ the debtors executed a security agreement with the PCA covering "'crops, growing crops . . . contract rights, accounts and general intangibles, existing or hereafter acquired.'" ⁸⁶ In 1983, the debtors entered into the PIK program and soon thereafter filed a petition for bankruptcy.⁸⁷ The debtors sought approval from the bankruptcy court to incur debt to pay farm operating expenses for 1983.⁸⁸ The debt was to be secured by an assignment of PIK payments to the Farmers Home Administration (FmHA).⁸⁹ However, the PCA objected to the proposed assignment on the basis of its perfected security

79. 779 F.2d at 1245.

80. *Id.* The court discussed U.C.C. § 9-203(3) (1977), which states, "[A] security agreement gives the secured party the right to proceeds." 779 F.2d at 1245; see *In re Judkins*, 41 Bankr. 369 (Bankr. M.D. Tenn. 1984). In *Judkins*, the debtor mowed his wheat crop after executing the PIK contract. *Id.* at 372 n.2. The court held that the PIK payments were subject to the Farmer's Home Administration (FmHA) security agreement since the PIK payments were proceeds traceable to crops subject to the security agreement. *Id.* at 373.

81. 779 F.2d at 1246-47. Proceeds of the assignment to the elevator, which occurred after the date of the bankruptcy, consisted of collateral which was covered by the bank's security interest. Absent a showing that it is inequitable, the creditor has a valid security interest in the proceeds. *Id.*; see also *In re Chaseley's Foods, Inc.*, 726 F.2d 303, 305 (7th Cir. 1983)(right to proceeds acquired after a petition in bankruptcy is filed is subject to interpretation of state and federal law). There would be no security interest in the crops, if proceeds of the collateral contained in the security agreement had not been used to finance the crops. *In re J. Catton Farms*, 779 F.2d at 1247; cf. *In re Barton*, 37 Bankr. 545 (Bankr. E.D. Wash. 1984). In *Barton*, the court held the parties did not intend to include PIK payments received after execution of the security agreement as collateral. *Id.* at 547. However, the security agreement covered general intangibles, but did not refer to farm products or crops. *Id.* at 546.

82. 779 F.2d at 1245.

83. For a case holding PIK payments to be contract rights, see *infra* notes 109-14 and accompanying text. "Contract rights," as a separate collateral classification, were excluded from the U.C.C. by the 1972 amendments and are now included under U.C.C. § 9-106 (1977) as "accounts." For an explanation of the elimination of contract rights as a class of collateral in the U.C.C., see SELECTED COMMERCIAL STATUTES *supra* note 19, app. 1, at 798. Regarding general intangibles, see *supra* note 33 (definition of "general intangibles" and cases holding that government production payments are general intangibles). For a discussion of cases holding PIK payments as general intangibles, see *infra* notes 85-114 and accompanying text.

84. Marsh, *supra* note 17, at 305.

85. 35 Bankr. 777 (Bankr. S.D. Iowa 1983), *aff'd*, 729 F.2d 561 (8th Cir. 1984).

86. *Id.* at 779. Under Iowa law, if there is no evidence otherwise, a security agreement is interpreted to cover future property interests arising from government farm programs. *Id.* at 781 (citing to IOWA CODE ANN. § 554.9204 (West 1974)). The parties must first agree that the security interest is to attach, either by executing a security agreement or by transferring possession of the collateral to the secured party. 35 Bankr. at 781.

87. 35 Bankr. at 780.

88. *Id.* at 778.

89. *Id.* at 780.

interest.⁹⁰ The bankruptcy court held the PCA's security agreement was intended to include future property interests in government farm programs such as PIK.⁹¹ The court also held that PIK payments under an executory contract⁹² were general intangibles; therefore, the PCA had a valid security interest because general intangibles were specifically listed in the security agreement.⁹³ The court stated that the debtors' reliance on 11 U.S.C. § 552 was implausible, because the PIK contract was entered into prior to bankruptcy.⁹⁴ Section 552 avoids security interests only to the extent that they encumber collateral acquired after the filing of the petition.⁹⁵

However, in *In re Kruse*,⁹⁶ the debtors entered the PIK program after filing a bankruptcy petition.⁹⁷ Before filing the petition, the debtors had entered into an extensive security agreement with the PCA, which failed to list accounts or general intangibles as collateral.⁹⁸ The court in *Kruse* found that one of the distinguishing factors in classifying PIK payments as proceeds was whether the crops were planted or not planted.⁹⁹ The Kansas bankruptcy court held that PIK payments received by the debtors for their growing crops were proceeds, since the crop was planted before the bankruptcy petition was filed.¹⁰⁰ The court also held that a security interest in crops attached when the crops were planted; therefore, so long as the crop was planted before the petition was filed, the PCA's security interest was valid.¹⁰¹

90. *Id.* at 779. The PCA claimed a lien on the PIK payments based on the after-acquired property clause in the security agreement which covered general intangibles. *Id.* at 780.

91. *Id.* at 781. The PIK payment was a general intangible, and therefore covered by the PCA's security agreement which was executed before the bankruptcy petition was filed. *Id.* at 783.

92. Although there is no statutory definition of an executory contract, the legislative history of 11 U.S.C. § 365 (1982 & Supp. III 1985) makes it clear that it "generally includes contracts on which performance remains due to some extent on both sides." H.R. REP. NO. 595, 95th Cong., 1st Sess. 347, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963; S. REP. NO. 989, 95th Cong., 2d Sess. 58, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787; accord, *Jenson v. Continental Fin. Corp.*, 591 F.2d 477, 481 (8th Cir. 1979)(a contract is executory where obligations of debtor and other party remain partially and materially unperformed); *In re Knutson*, 563 F.2d 916, 917 (8th Cir. 1977)(a contract is executory where both sides have substantial obligations to perform); *In re Am. Magnesium Co.*, 488 F.2d 147, 152 (5th Cir. 1974)(a contract is executory where both parties have on-going commitments); cf. BLACK'S LAW DICTIONARY 512 (5th ed. 1979)(executory contract is a contract where performance has not been fully completed). For discussion of executory contracts as property of the bankruptcy estate, see Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 MINN. L. REV. 341, 343 (1980).

93. 35 Bankr. at 781.

94. *Id.* at 783. The PIK contract, creating the general intangible, was entered into before the petition for bankruptcy was filed. *Id.*

95. *Id.* The court, applying 11 U.S.C. § 552(b), reasoned that the PCA's security interest extended to attach to PIK payments received by the debtors after a petition for bankruptcy was filed. 35 Bankr. at 781. For the text of § 552(b), see *supra* note 29.

96. 35 Bankr. 958 (Bankr. D. Kan. 1983).

97. *Id.* at 960.

98. *Id.* The security agreement listed numerous items as collateral, such as corn, wheat, and all proceeds and products therefrom. The very "breadth of the security agreement was indicative of an intent to include all of the debtors' farm property interests, including government production payments." *Id.*

99. *Id.* at 965-66.

100. *Id.* at 965; cf. *In re Munger*, 495 F.2d 511, 512-13 (9th Cir. 1974)(abandonment and subsidy payments); *In re Sunberg*, 35 Bankr. 777, 783-84 (Bankr. S.D. Iowa 1983)(PIK payments), *aff'd*, 729 F.2d 561 (8th Cir. 1984); *In re Preisser*, 33 Bankr. 65, 67 (Bankr. D. Colo. 1983)(PIK payments as rents or profits from deed of trust on land); *In re Nivens*, 22 Bankr. 287, 291 (Bankr. N.D. Tex. 1982)(deficiency payments).

101. 35 Bankr. at 966; see *United States v. Minster Farmers Coop. Exch., Inc.*, 430 F. Supp. 566, 569 (N.D. Ohio 1973)(security interest in crops attached when crops were planted); *United States v.*

The *Kruse* court further held that PIK payments received in return for not planting crops were not proceeds, but suggested that they were general intangibles or contract rights.¹⁰² The court stated that the consideration for the debtors' agreement not to plant future crops could only be a general intangible in the form of the right to receive PIK payments.¹⁰³ The right arose only because the debtors agreed "not to create collateral" by not planting a crop.¹⁰⁴ However, the PCA's security interest did not attach because the security agreement did not include general intangibles.¹⁰⁵ The court further stated that even assuming the security agreement included general intangibles, the security interest would not be enforceable because 11 U.S.C. § 552(a) avoids security interests that attach after the filing of a petition in bankruptcy.¹⁰⁶ The general intangibles did not exist prior to the filing of the petition in bankruptcy because the debtors had not entered the PIK program until after the petition was filed.¹⁰⁷ Since the security interest was unenforceable as to the general intangibles, 11 U.S.C. § 552(b) would not allow its enforcement as to PIK payments as proceeds of the general intangibles.¹⁰⁸

Two years later in *In re Lions Farms, Inc.*,¹⁰⁹ the Kansas bankruptcy court clarified its holding in *Kruse*.¹¹⁰ In *Lions*, the court held that PIK payments arising under an executory contract¹¹¹ not to plant crops were unpaid contract rights, not general intangibles.¹¹² The court stated that under the "mutually exclusive definitions" of section 84-9-106 of the Kansas statutes, PIK payments cannot be both general intangibles and contract rights.¹¹³ Since the bank had a

Greenwich Mill & Elevator Co., 291 F. Supp. 609, 612 (N.D. Ohio 1968)(security interest of FmHA attached when soybean crop was planted); see also *First Nat'l Bank v. Milford*, 239 Kan. 151, 158, 718 P.2d 1291, 1297 (1986)(PIK payment held to be proceeds of planted crops).

102. 35 Bankr. at 966.

103. *Id.* The debtors did not plant a crop, but entered into the PIK program after the petition for bankruptcy was filed; therefore, no general intangibles were created until after bankruptcy. *Id.*

104. *Id.*

105. *Id.*; see *In re Mattick*, 45 Bankr. 615 (Bankr. D. Minn. 1985). In *Mattick*, the debtors received PIK payments for foregoing the planting of crops. The secured party was aware of the PIK program at the time the PIK contract was executed, but included the PIK entitlements only on the loan documents and not the security agreement. The court held that PIK payments were general intangibles. *Id.* at 617; cf. *In re Judkins*, 41 Bankr. 369, 372 (Bankr. M.D. Tenn. 1984)(PIK payments were proceeds even though no crop was planted).

106. 35 Bankr. at 966. For the text of § 552(a), see *supra* note 28.

107. 35 Bankr. at 966.

108. *Id.* For the text of § 552(b), see *supra* note 29.

109. 54 Bankr. 241 (Bankr. D. Kan. 1985).

110. *Id.* at 245. The *Lions* court stated that the *Kruse* court had suggested that PIK payments could be either general intangibles or contract rights, when actually the *Kruse* court held PIK payments to be general intangibles. 35 Bankr. at 966; see *supra* note 103 and accompanying text.

111. For an explanation of executory contracts, see *supra* note 92. Under an executory contract, the "farmer must perform and the government must pay." 54 Bankr. at 244.

112. 54 Bankr. at 245.

113. *Id.* For a definition of general intangibles, see *supra* note 33. The term "contract rights," and not the classification of collateral it gave rise to, has been deleted as unnecessary. The term "account" now incorporates many executory contract rights. KAN. STAT. ANN. § 84-9-106 Kansas comment (1983). The definition of account is "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." KAN. STAT. ANN. § 84-9-106 (1983).

Prior to the 1983 amendments to the Kansas Commercial Code, contract rights meant "any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." Account meant "any right to payment for goods sold or leased or services rendered which is not evidenced by an instrument or chattel paper." KAN. STAT. ANN. § 84-9-105 (Supp. 1974)(current definitions at KAN. STAT. ANN. § 84-9-106 (1983)). See generally Balloun,

perfected security interest in the "proceeds of crops and contract rights," the bankruptcy trustee could not set aside the bank's security interest in the PIK payments.¹¹⁴

In *In re Schmalig*,¹¹⁵ the Seventh Circuit Court of Appeals considers the issue of whether PIK payments are "proceeds" of an unplanted crop.¹¹⁶ In *Schmalig*, the debtors, in May, 1982, entered into a security agreement with the First National Bank of Freeport (Bank) covering "corn and all other crops grown or growing . . . which are now owned or existing . . . together with all property of a similar nature or kind . . . which may be hereafter acquired . . .'"¹¹⁷ In 1983, the debtors contracted to participate in the PIK program,¹¹⁸ and soon thereafter assigned their PIK corn payments to three parties.¹¹⁹ In exchange, each of the three parties loaned the debtors money.¹²⁰ In October, one of the assignees attempted to obtain the PIK corn and was refused, because the Bank claimed a security interest in the PIK corn under the 1982 security agreement.¹²¹ In March, 1984, the debtors filed a voluntary petition¹²² under Chapter 11 of the Bankruptcy Code.¹²³ Later that month, the debtors filed a complaint in the Illinois bankruptcy court under section 544(a) of the Bankruptcy Code¹²⁴ to set aside the Bank's lien on the PIK corn.¹²⁵

Survey of Kansas Law: Secured Transactions, 16 U. KAN. L. REV. 437 (1968)(referring to modification of the U.C.C. in Kansas since its enactment); Note, *Changes in Article Nine of the Kansas Commercial Code*, 16 WASHBURN L.J. 212 (1976)(discussion of Kansas' modification to the U.C.C.).

114. 54 Bankr. at 245.

115. 783 F.2d 680 (7th Cir. 1986).

116. *Id.* at 681.

117. *Id.* Leland and Mary Schmalig are the debtors in this action. *Id.*

118. *Id.* For discussion and the pertinent regulations of the PIK program, see *supra* notes 45-54 and accompanying text.

119. 783 F.2d at 681. Esther Schmalig, Carroll Service Company, and The State Bank of Pearl City were the assignees of the PIK corn. *Id.*

120. *Id.* Esther Schmalig loaned debtors \$47,537.92 in exchange for 22,960 bushels of PIK corn. The Carroll Service Company sold supplies to debtors with a balance due of \$32,196.03 and was assigned 6,200 bushels of PIK corn. The State Bank of Pearl City received an assignment of 6,612 bushels of PIK corn for a loan to debtors of \$15,300. *Id.*

121. *Id.* The PIK corn was held by Johnston's Feed Service for delivery to assignees. *Id.*

122. *Id.* at 681-82. A voluntary bankruptcy petition is one filed by the debtor. 11 U.S.C. § 301 (1982).

In an involuntary bankruptcy, creditors file a bankruptcy petition against the debtor. 11 U.S.C. § 303 (1982 & Supp. III 1985). Farmers are specifically excluded from subjection to an involuntary petition. 11 U.S.C. § 303(a) (1982). "An involuntary case may be commenced only under Chapter 7 or 11 of this title, and only against a person, except a farmer . . . that may be a debtor under the [bankruptcy] chapter [under] which such case is commenced." *Id.* The reason farmers are immune from involuntary petitions is explained in part by the legislative history of the statute, which states that "farmers are excepted because of the cyclical nature of their business. One drought year or one year of low prices, as a result of which a farmer is temporarily unable to pay his creditors, should not subject him to an involuntary bankruptcy." H.R. REP. NO. 595, 95th Cong., 1st Sess. 322, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 6278. *But see* Marsh, *Farmers' Exemptions from Involuntary Bankruptcy*, 15 U.C.C. L.J. 162, 162 (1982)(current Bankruptcy Code does not shield a significant number of farmers from involuntary bankruptcy filings).

123. 783 F.2d at 681-82. For a discussion of Chapter 11 of the Bankruptcy Code as it pertains to farmers, see *supra* note 78.

124. 783 F.2d at 682. The "strong arm provision" of the Bankruptcy Code states,

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the cases, and that obtains, at such time and with respect to such credit, a judicial lien

The bankruptcy court ruled in favor of the Bank, construing the language of the security agreement very broadly.¹²⁶ The court classified the PIK payments as proceeds and held that the Bank's perfected security interest covered the payments.¹²⁷ The United States District Court for Illinois affirmed.¹²⁸

On appeal, the Seventh Circuit Court of Appeals reverses.¹²⁹ The court holds that the corn received from the PIK program did not constitute crop proceeds; therefore, the Bank's security agreement, by not specifically referring to general intangibles, contract rights, or the PIK entitlements, did not include the PIK payments and the debtors' assignments of their PIK payments were valid.¹³⁰ The court states that creditors should be limited strictly to the collateral identified in the security agreement.¹³¹ In this case, the security agreement granted the Bank a security interest in specific assets of the debtors, but did not refer to all of the debtors' farm-related assets.¹³²

In classifying the Schmalings' PIK payments as proceeds, the lower courts had construed "proceeds" to include "anything that is received in consequence of the disposition of collateral."¹³³ However, the Seventh Circuit Court of Appeals states that there was no crop of which to dispose, because the PIK program requires farmers not to plant a crop.¹³⁴ Therefore, PIK payments cannot be proceeds of collateral that never existed.¹³⁵

The district court had been concerned about fraud,¹³⁶ reasoning that if PIK payments were not classified as proceeds, the farmer could abandon his crops to participate in the PIK program and dissipate the PIK payments, thereby preventing a creditor from claiming them.¹³⁷ The Seventh Circuit Court of Ap-

on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists. . . .

11 U.S.C. § 544(a) (1982 & Supp. II 1984).

125. 783 F.2d at 682.

126. *Id.*

127. *Id.* The court concluded, "[A]lthough the agreement did not contemplate the not-as-yet commenced Payment-in-Kind program and its proceeds specifically, its coverage was intended to be broad so as [to] cover all of the debtor's farm-related assets." *Id.*

128. *Id.* Since PIK payments are figured on the basis of a debtor's prior growing history, the federal district court found that the debtors had "exchanged" the corn they would have planted for the PIK corn. Thus, the court held that the payments were "proceeds" under U.C.C. § 9-306(2) (1977). 783 F.2d at 682 (citing *Schmaling v. First Nat'l Bank of Freeport*, Mem. Op. No. 84-A-2037 (Bankr. N.D. Ill. Aug. 1, 1984)). A "security interest continues in collateral notwithstanding sale, exchange or other disposition . . . and also continues in any identifiable proceeds . . ." U.C.C. § 9-306(2) (1977); see *In re Connelly*, 41 Bankr. 217, 220 (Bankr. D. Minn. 1984) ("proceeds is meant to include anything that is received in consequence of the disposition of collateral"); WHITE & SUMMERS, *supra* note 22, § 24-6, at 1011 (discussion of security interests in proceeds).

129. 783 F.2d at 681.

130. *Id.* at 684.

131. *Id.* at 682; see *In re Martin Grinding & Mach. Works, Inc.*, 42 Bankr. 888, 892 (Bankr. N.D. Ill. 1984) (security interest construed narrowly from terms of security agreement); *Allis-Chalmers Corp. v. Staggs*, 117 Ill. App. 3d 428, 432, 453 N.E.2d 145, 149 (1983) (creditor's security interest limited to security agreement and not financing statement terms); 8 R. ANDERSON, TREATISE ON THE UNIFORM COMMERCIAL CODE § 9-203.15, at 668 (3d ed. 1980) (security agreement is not effective beyond its terms).

132. 783 F.2d at 682.

133. *Id.* For the pertinent language of U.C.C. § 9-306(2), see *supra* note 128; see also WHITE & SUMMERS, *supra* note 22, § 24-6, at 1011 (discussion on the reach of the U.C.C. proceeds provision).

134. 783 F.2d at 683.

135. See *id.* See generally *Marsh*, *supra* note 17, at 312.

136. 783 F.2d at 682, 684 (district court opinion is unreported).

137. *Id.* at 684. This reasoning is supported by federal regulations, which state that PIK pay-

peals does not foresee fraud as a sufficient threat to justify construction of a loosely drafted security agreement in favor of the Bank.¹³⁸ The court states that the Bank should have been aware of the existence of government programs and could have drafted the security agreement to cover government entitlements directly, or by reference to general intangibles or contract rights.¹³⁹

With this decision, the Seventh Circuit Court of Appeals makes it clear that creditors need to meticulously draft security agreements¹⁴⁰ when dealing with farmers and foresee the possibility of farmer participation in government production payment programs. In the bankruptcy context, the extent to which government production payments are encumbered by a security agreement seems to turn not on the intent of the parties, but on: (1) the date of the security agreement's execution and its contents; (2) the date the debtor contracted to participate in the PIK program; (3) the date the petition for bankruptcy was filed; and (4) whether or not crops were planted.¹⁴¹

In *In re Schmalig*, the court holds that PIK payments, under an agreement not to plant crops, are general intangibles rather than proceeds.¹⁴² Courts have been inconsistent in their classification of government production payments as collateral under the U.C.C. Inconsistent judicial treatment of government production payments directly conflicts with the U.C.C.'s purpose of achieving uniformity in commercial transactions.¹⁴³ Rather than relying on case-by-case interpretations, the provisions of the U.C.C. should be amended to clearly provide a classification for government production payments in order to keep farmers and creditors out of the courts.

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ments are to compensate farmers for foregoing production and the payments are to be considered the actual production of the crop for the year the crop is diverted. 48 Fed. Reg. 9,233 (1983). Some courts have determined that if PIK payments are not proceeds, an artificial distinction is created which would allow farmers to defeat creditors' security interests. See *In re Munger*, 495 F.2d 511, 513 (9th Cir. 1974)(distinction of form over substance as to government payments would be contrary to parties' intent); *In re Cupp*, 38 Bankr. 953, 956 (Bankr. N.D. Ohio 1984)(distinction would be between proceeds from sale of crops grown and payments received based on diverting production); *In re Lee*, 35 Bankr. 663, 666 (Bankr. N.D. Ohio 1983)(if security interest does not attach to PIK payments, debtors have ability to change their decision to forgo production).

138. 783 F.2d at 684.

139. *Id.* "[L]and diversion programs have been in existence . . . since at least 1949. As a federally chartered instrumentality . . . the [bank] could hardly claim to be ignorant as to [the] existence or nature of these programs; nor could it claim to be unversed in drafting security agreements which adequately describe government entitlements as collateral." *In re Binning*, 45 Bankr. 9, 12-13 (Bankr. S.D. Ohio 1984).

140. 783 F.2d at 684; see also *In re Peters*, 60 Bankr. 711, 714 (Bankr. D. Minn. 1986)(security agreement included PIK payments specifically).

141. 783 F.2d at 684. *Contra In re Cupp*, 38 Bankr. 953 (Bankr. N.D. Ohio 1984). "[T]he intent of the parties is the controlling factor whenever a dispute arises over whether or not a contract governs a subsequent circumstance." *Id.* at 955-56.

142. 783 F.2d at 684.

143. For an explanation of the purpose of Article Nine, see *supra* note 19.